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Supreme Court, U.S.
FILED
AUG 07 2007
OFFICE OF THE CLERK

No. 07-07-164

In The

Supreme Court of the United States

KINDER MORGAN CO_2 COMPANY, L.P.

Petitioner,

v.

RUSSELL GARY HEIMANN, PECOS SLOPE ROYALTY TRUST AND RIO PETRO LTD., INDIVIDUALLY AND ON BEHALF OF ALL OTHER PRIVATE ROYALTY AND OVERRIDING ROYALTY OWNERS IN THE BRAVO DOME CARBON DIOXIDE UNIT, NEW MEXICO, SIMILARLY SITUATED,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeals Of New Mexico

PETITION FOR A WRIT OF CERTIORARI

JOHN B. POUND
LONG, POUND & KOMER, P.A.
2200 Brothers Road
P.O. Box 5098
Santa Fe, NM 87502-5098
(505) 982-8405

GUY S. LIPE
Counsel of Record
VINSON & ELKINS L.L.P.
2500 First City Tower
1001 Fannin
Houston, TX 77002-6760
(713) 758-1109

Counsel for Petitioner Kinder Morgan CO_2 Company, L.P.

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Did the New Mexico Court of Appeals err in holding that the presumption favoring arbitration under the Federal Arbitration Act is less applicable to narrow arbitration clauses than broad arbitration clauses, consistent with decisions of the Second Circuit, Third Circuit, Sixth Circuit, Eighth Circuit, Tenth Circuit, and the Massachusetts Supreme Court, but contrary to decisions of the Fifth Circuit, the Eleventh Circuit, the D.C. Circuit, a district court in the Ninth Circuit, the Texas Supreme Court, and the Alaska Supreme Court?

2. Did the New Mexico Court of Appeals err in holding that arbitration under the Federal Arbitration Act may be denied based on lack of clarity in the plaintiffs' complaint, resolving doubts arising out of unclear allegations in favor of court litigation, contrary to the federal presumption in favor of arbitration and federal decisions requiring that doubts concerning arbitrability arising from vague pleadings be resolved in favor of arbitration?

3. Did the New Mexico Court of Appeals err in holding that arbitration under the Federal Arbitration Act may be denied based on a plaintiff's characterization of its claims and the legal labels a plaintiff places on its claims, contrary to decisions of the Fourth and Seventh Circuits?

4. Did the New Mexico Court of Appeals err in adopting a rule permitting broad construction of exclusionary clauses in arbitration agreements governed by the Federal Arbitration Act, contrary to a Fourth Circuit decision requiring that exclusionary clauses be construed narrowly in light of the federal presumption favoring arbitration?

PARTIES TO THE PROCEEDING

Petitioner Kinder Morgan CO_2 Company, LP is the defendant in the trial court proceedings, was the appellant in the proceedings in the New Mexico court of appeals, and was the petitioner in the proceedings in the New Mexico Supreme Court.

Respondents Russell Gary Heimann,[1] Pecos Slope Royalty Trust, and Rio Petro Ltd., individually and on behalf of other royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico, similarly situated, are plaintiffs in the trial court, were appellees in the proceedings in the New Mexico court of appeals, and were respondents in the proceedings in the New Mexico Supreme Court.

[1] At the inception of this case, J. Casper Heimann was a named plaintiff, but he died during the course of the proceedings in the trial court. J. Casper Heimann's son, Russell Gary Heimann, has been substituted as a plaintiff in lieu of J. Casper Heimann.

RULE 29.6 STATEMENT

Petitioner Kinder Morgan CO_2 Company, L.P. is a limited partnership that is wholly owned by Kinder Morgan Energy Partners, L.P., a master limited partnership that has partnership units that are traded on the New York Stock Exchange. The general partner of Kinder Morgan Energy Partners, L.P. is Kinder Morgan G.P., Inc., which owns all of the voting securities of Kinder Morgan Management, LLC. Pursuant to a delegation of control agreement, Kinder Morgan G.P. Inc. delegated to Kinder Morgan Management, LLC, to the fullest extent permitted under Delaware law and the applicable partnership agreement, all of its power and authority to manage and control the business and affairs of Kinder Morgan Energy Partners, L.P. Shares of Kinder Morgan Management, LLC are traded on the New York Stock Exchange.

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OPINIONS AND ORDERS BELOW

The opinion of the New Mexico court of appeals dated August 8, 2006, is reported at *Heimann v. Kinder Morgan CO_2 Company, L.P.*, 140 N.M. 552, 144 P.3d 111 (N.M. Ct. App. 2006), and is reproduced in the Appendix at App. 1-19. The order of the New Mexico Supreme Court dated October 11, 2006, granting Kinder Morgan CO2 Company, L.P.'s petition for writ of certiorari, is not reported and is reproduced in the Appendix at App. 22-23. The order of the New Mexico Supreme Court dated May 10, 2007, quashing the writ of certiorari, is not reported and is reproduced in the Appendix at App. 24-26. The order of the trial court denying Petitioner's motion for stay pending arbitration and to compel arbitration signed on March 8, 2005, and entered on March 11, 2005, is not reported and is reproduced in the Appendix at App. 20-21.

JURISDICTION

On August 8, 2006, the New Mexico court of appeals issued its decision affirming the trial court's denial of Petitioner's motion to compel arbitration and for stay pending arbitration. App. 1-19. Petitioner filed a timely petition for writ of certiorari with the New Mexico Supreme Court on August 28, 2006, which was granted by order dated October 11, 2006. App. 22-23. Following oral argument on May 7, 2007, the New Mexico Supreme Court entered an order on May 10, 2007, quashing the writ of certiorari as improvidently granted. App. 24-26.

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a), as the decisions of the New Mexico courts deprived Petitioner of its arbitration rights, including the

right to a stay pending arbitration and an order compelling arbitration, under the Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.* In a number of prior cases, this Court has reviewed and reversed decisions of state courts that held that the Federal Arbitration Act did not require arbitration of a plaintiff's claims and that permitted the case to proceed in the state trial court on the merits. *See, e.g., Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440 (2006); *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995). This Petition for Writ of Certiorari is filed timely pursuant to 28 U.S.C. § 2101(c) and S. Ct. R. 13.1, having been filed within 90 days after the New Mexico Supreme Court entered its May 10, 2007 order quashing its previously-issued writ of certiorari and thereby denying discretionary review of the decision of the New Mexico court of appeals.

STATUTORY PROVISIONS INVOLVED

The Federal Arbitration Act provides, in pertinent part:

> **§ 2. Validity, irrevocability and enforcement of agreements to arbitrate**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and

enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (July 30, 1947, c. 392, 61 Stat. 670).

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (July 30, 1947, c. 392, 61 Stat. 670).

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the

manner provided for in such agreement. Five days notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

9 U.S.C. § 4 (July 30, 1947, c. 392, 61 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233).

STATEMENT OF THE CASE

This case presents issues of exceptional importance under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* ("FAA"). The New Mexico courts in this case have refused to enforce Kinder Morgan's arbitration rights under the FAA. The New Mexico court of appeals' published opinion adopts a restrictive and erroneous approach to application of the presumption favoring arbitration under the FAA in the context of narrow arbitration clauses (an issue that has divided the United States Courts of Appeals and the highest courts of several states). Consistent with its restrictive approach to the presumption in favor of arbitration, the opinion adopts rules governing the determination of arbitrability that (1) allow a court to deny arbitration based on "lack of clarity" in a plaintiff's complaint and a plaintiff's unilateral characterization of its claims, and (2) allow a court to broadly construe exclusionary clauses in arbitration agreements in a manner that eliminates arbitration rights for all contract disputes. The New Mexico court of appeals' decision creates a presumption in favor of court litigation, rather than arbitration, when the arbitration clause is narrow, contrary to the decisions of several of the United States Courts of Appeals and two state supreme courts.

Factual Background

The Bravo Dome Unit ("the Unit") is a carbon dioxide unit located in Northeastern New Mexico. Since January

2000, Kinder Morgan has owned a working interest in the Unit (having acquired its interest from Shell) and has produced and sold carbon dioxide and paid royalties thereon to royalty owners in the Unit. The carbon dioxide produced at the Unit is transported through pipeline and other transportation systems to Permian Basin oil fields in West Texas, where it is sold to oil producers operating there for use in enhanced recovery operations.

Prior to Kinder Morgan's acquisition of its interest in the Unit, a Settlement Agreement was executed in 1998 in connection with a prior class action lawsuit brought by royalty owners against Amoco, Amerada Hess, and Shell, the producers at the Unit at that time. The Settlement Agreement included provisions relating to the methodology for calculating future royalties. That methodology involves calculation by each producer of a volume-weighted-average "net-back" price for that producer's share of carbon dioxide, which is calculated using the sales prices that the producer obtains in its sales of carbon dioxide at the Permian Basin, reduced by charges that the producer incurs to transport the carbon dioxide to the sales points. The resulting "net-back" price is the price on which royalty is to be paid to the royalty owners.[2]

During negotiation of the Settlement Agreement, the parties reviewed the existing sales and transportation agreements, and in the Settlement Agreement, they identified contracts that would be pre-approved by the royalty owners for use in calculating the net-back price and that would not be subject to challenge with regard to future royalty calculations (defined in the Settlement

[2] See Settlement Agreement § 14 (App. 98-102).

Agreement as "Qualified" contracts).[3] It was clear, however, that over time, the producers would enter into new contracts for the sale and transportation of carbon dioxide. Those new contracts were defined in the Settlement Agreement as "Non-Qualified" contracts. Regarding the use of Non-Qualified prices and charges in the "net-back" royalty calculations, the parties agreed as follows:

> Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or approved herein, or that future royalty payments resulting from the use of such benchmarks, are improper. Amoco, Hess, and Shell, on the one hand, and Plaintiffs and members of the Class, on the other, intend, only, to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper.[4]

Having "omit[ted] any agreement" regarding the propriety of Non-Qualified prices and charges utilized in the royalty calculations, the parties established a dispute resolution procedure in the Settlement Agreement for resolving royalty-owner challenges to the propriety of Non-Qualified prices and charges utilized in those calculations – arbitration. The arbitration clause is found in Section 16 of the Settlement Agreement:

> Any claims asserted by Plaintiffs or members of the Class against Amoco, Hess, or Shell *regarding (a) the price or value under Non-Qualified*

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[3] *Id.*

[4] See Settlement Agreement § 14(c) (App. 100).

> *Contracts . . . utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners* and, (b) *regarding Non-Qualified Other Transportation Charges . . . utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding arbitration. . . .* This provision concerning arbitration applies only to the claims identified in this paragraph 16 and shall, in no event, apply to any future claims for breach of this Agreement.

App. 102-103 (emphasis added).

The exclusion from arbitration set out in the last sentence of Section 16 for "future claims for breach of this Agreement" was necessary to insure that a producer could not invoke arbitration in the event it violated express prohibitions in the Settlement Agreement against the use of particular types of deductions in the royalty calculations. For example, Section 9.2 of the Settlement Agreement prohibits deduction of "any costs of Unit Compression, Dehydration, and Gathering" in the royalty calculations. App. 88-89. Section 10 prohibits deduction of a "marketing fee." App. 89-90. Section 11.2 prohibits deduction of mainline transportation greater than certain amounts. App. 92-94. Section 11.4 prohibits deductions for transportation to "the Postle Connection Point." App. 95-96. The exclusionary clause in the last sentence of Section 16 made it clear that the royalty owners would have the right to go back to court in the event a producer deducted a Non-Qualified charge that breached one of these prohibitions in the Settlement Agreement. Because of the exclusionary clause, the producer could not invoke arbitration with regard to such a claim.

Plaintiffs' Claims

On July 26, 2004, Plaintiffs filed a class action arbitration proceeding against Kinder Morgan, invoking the arbitration clause in Section 16 of the Settlement Agreement. A week later, Plaintiffs filed a "Withdrawal" of their arbitration demand and immediately filed this lawsuit in New Mexico state court, asserting the same claims.

The Complaint (App. 27-44) asserts claims for (1) violation of the Unfair Trade Practices Act, (2) constructive fraud, (3) breach of contract and of an alleged implied covenant to act in good faith, (4) breach of an alleged implied covenant to market, and (5) unjust enrichment.[5] The claims are based on allegations that Kinder Morgan has "fabricat[ed]," "attributed," "fixed" or "unilaterally set" prices and charges that are not reflective of the value of the carbon dioxide and that Kinder Morgan did not obtain the best prices reasonably available in its contracts for the sale of carbon dioxide.[6] The challenge to the adequacy of Kinder Morgan's prices for sale of carbon dioxide under contracts that were not pre-approved in the Settlement Agreement (which includes all of Kinder Morgan's new contracts since it was not an interest owner in the Unit at the time of the Settlement Agreement) by definition are claims regarding Non-Qualified prices that fall within the scope of the arbitration clause

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[5] Plaintiffs originally sought certification of a class with regard to each of these claims. However, Plaintiffs subsequently dropped their request for certification of a class with regard to the claims for violation of the New Mexico Unfair Trade Practices Act, constructive fraud, and unjust enrichment. Plaintiffs continue to pursue those claims in their individual capacities.

[6] See, *e.g.*, Complaint §§ 10, 15, 25, 27, 43, 50 (App. 31-41).

in Section 16 of the Settlement Agreement.[7] In fact, in a brief filed in the trial court, Plaintiffs conceded that this case "involves a search for the truth behind the Non-Qualified Contracts. . . ." App. 80. Plaintiffs' claims, challenging the Non-Qualified prices utilized by Kinder Morgan in its royalty calculations, were precisely the type of claims that the parties to the Settlement Agreement agreed to arbitrate in Section 16.

Kinder Morgan's Motion for Stay and to Compel Arbitration

In response to the lawsuit, Kinder Morgan filed a motion to compel arbitration and for a stay pending arbitration under the FAA and the New Mexico arbitration statute. App. 45-65. Kinder Morgan's motion specifically invoked Kinder Morgan's arbitration rights under the FAA. See App. 46 ("Both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act require that Plaintiffs be compelled to arbitrate their claims and that this action be stayed pending arbitration"); App. 52 ("the Federal Arbitration Act applies and requires enforcement of the arbitration clause contained in Section 16 of the Settlement Agreement"); App. 63 ("The FAA and the New Mexico Uniform Arbitration Act mandate that Plaintiffs be compelled to arbitrate, and that this case be stayed pending arbitration").

The trial court denied Kinder Morgan's motion in an order entered on March 11, 2005 (App. 20-21), and Kinder Morgan appealed.

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[7] See Settlement Agreement §§ 14, 14(c), 14(e), 14(f), 14(g), 14(h), 14(i) (App. 98-102).

The Decision of the New Mexico Court of Appeals

On August 8, 2006, the New Mexico court of appeals affirmed the denial of the motion in a reported opinion, *Heimann v. Kinder Morgan CO_2 Company, L.P.*, 140 N.M. 552, 144 P.3d 111 (N.M. Ct. App. 2006), reproduced at App. 1-19, depriving Kinder Morgan of its arbitration rights under the FAA.

In upholding the trial court's denial of arbitration, the New Mexico court of appeals broadly construed the exclusionary clause in the arbitration agreement to exclude from arbitration all contract disputes regarding Non-Qualified prices, holding that the exclusionary clause rendered only non-contract claims potentially subject to arbitration. App. 9-13. The court recognized that the Settlement Agreement permitted the use of prices other than those characterized as "Qualified" and that the parties had expressly stated their intent to "omit any agreement" regarding the propriety of Non-Qualified prices utilized in the royalty calculations. App. 3. The court nevertheless held that the exclusions for "claims for breach" covered the Plaintiffs' attack on Kinder Morgan's use of Non-Qualified prices because the Plaintiffs had characterized certain of their challenges to Kinder Morgan's utilization of Non-Qualified prices as "claims for breach." App. 10, 12-13. The court held that the Plaintiffs' characterization of their claims was controlling and that arbitration therefore was properly denied. App. at 10, 12-13.

The court did not address Kinder Morgan's narrower interpretation of the exclusionary clause. That narrower interpretation was based on (1) the parties' stipulation in Section 14(c) of the Settlement Agreement that they were

"omit[ting] any agreement" concerning the propriety of Non-Qualified prices used in the royalty calculations, establishing that the parties could not have intended a challenge to the propriety of a Non-Qualified price to constitute a "claim for breach of this Agreement" that was excluded from arbitration,[8] and (2) the contractual prohibitions on use of certain types of deductions in the royalty calculations, such as the prohibitions found in Sections 9.2, 10, 11.2, and 11.4 discussed above, violation of which would give rise to a "claim for breach" that would not be arbitrable by virtue of the exclusionary clause in the last sentence of Section 16.[9] Rather than address Kinder Morgan's narrower interpretation of the exclusionary clause as covering only claims for violation of the contractual prohibitions in the Settlement Agreement, the court of appeals simply held that the Plaintiffs' characterization of their claims as claims for "breach" of the Settlement Agreement was controlling. App. 10, 12-13. As a result, the court of appeals refused to order arbitration of the very type of claims that the arbitration clause was intended to cover.

The court of appeals recognized that the exclusionary clause was inapplicable to Plaintiffs' non-contract claims but it nevertheless denied arbitration of those claims as well, based on a "lack of clarity" in the Plaintiffs' Complaint. The court noted that the Complaint could be construed to assert arbitrable claims, but it held that the allegations were "not clear," and based on that "lack of clarity," it held that the trial court had properly denied

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[8] See Settlement Agreement § 14(c) (App. 100).

[9] App. 88-89, 92-96.

arbitration and that the proceedings should continue in the trial court unless and until it becomes "clear" that the claims are arbitrable. App. 15-19. The court therefore resolved doubts regarding arbitrability in favor of court litigation instead of arbitration, contrary to the federal presumption in favor of arbitration under the FAA that requires that doubts be resolved in favor of arbitration. In so holding, the court adopted a rule that rewards vague and artful pleading designed to avoid arbitration rights. In permitting the trial court proceedings to go forward, the court of appeals deprived Kinder Morgan of one of the key advantages to arbitration that underlies the federal policy favoring arbitration – avoidance of expansive and expensive discovery that is unavailable in arbitration.

All of the court of appeals' rulings flowed from its restrictive and erroneous view of the role of the presumption favoring arbitration in the context of a narrow arbitration clause.

Kinder Morgan's Petition for Review by the New Mexico Supreme Court

Kinder Morgan filed a petition for writ of certiorari in the New Mexico Supreme Court, which was granted in October 2006. See App. 22-23. However, after oral argument was held on May 7, 2007, the New Mexico Supreme Court entered an order quashing the writ of certiorari. See App. 24-26. Pursuant to that order, the case has now been remanded to the trial court for further proceedings on the merits.

REASONS FOR GRANTING THE WRIT

I. This Case Presents an Important Issue Regarding Application of the Presumption Favoring Arbitration to Narrow Arbitration Clauses That Has Divided the Circuit Courts of Appeals and the State Supreme Courts.

This Court has held that under the Federal Arbitration Act, there is a strong federal policy favoring arbitration, giving rise to a presumption in favor of arbitration requiring that all doubts regarding the arbitrability of claims be resolved in favor of arbitration. *Moses H. Cone Memorial Hospital v. Mercury Const. Corp.*, 460 U.S. 1, 24-25 (1983) ("The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."); *Mitsubishi Motors Corp. v. Soler-Chrylser Plymouth, Inc.*, 473 U.S. 614, 626 (1985) (quoting the *Moses H. Cone* rule and stating that "the parties' intentions control, but those intentions are generously construed as to issues of arbitrability").

A hotly debated issue in this case from inception has been the extent to which the presumption favoring arbitration applies to a narrow arbitration clause. That is an issue that has divided the United States Courts of Appeals and several state supreme courts.

A. The Circuit Courts of Appeals and the State Supreme Courts Are Sharply Divided on Whether the Presumption Favoring Arbitration Is Less Applicable or Equally Applicable to Narrow Arbitration Clauses as Compared to Broad Arbitration Clauses.

The Second,[10] Third,[11] Sixth,[12] Eighth,[13] and Tenth[14] Circuit Courts of Appeal and the Massachusetts Supreme

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[10] *Louis Dreyfus Negoce S.A. v. Blystad Shipping and Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001) ("[I]f reviewing a narrow clause, the court must determine whether the dispute is over an issue that 'is on its face within the purview of the clause. . . . ' Where the arbitration clause is broad, 'there arises a presumption of arbitrability.' ") (citations omitted).

[11] *Trap Rock Industries Inc. v. Local 825, Intern. Union of Operating Engineers, AFL-CIO*, 982 F.3d 884, 888 n. 5 (3d Cir. 1992) ("Because the arbitration provision . . . is narrowly crafted to apply to only certain disciplinary discharges and layoffs, . . . the presumption of arbitrability . . . [is] inapposite"); *Local 827, Intern. Broth. of Elec. Workers, AFL-CIO v. Verizon New Jersey, Inc.*, 458 F.3d 305, 310-311 (3d Cir. 2006) (same).

[12] *Simon v. Pfizer Inc.*, 398 F.3d 765, 775 (6th Cir. 2005) ("This Court has drawn a clear line between the extensive applicability of general arbitration provisions and the more narrow applicability of arbitration clauses tied to specific disputes. When faced with a broad arbitration clause, such as one covering *any* dispute arising out of an agreement, a court should follow the presumption of arbitration and resolve doubts in favor of arbitration.") (emphasis in original).

[13] *Twin City Monorail, Inc. v. Robbins & Myers, Inc.*, 728 F.2d 1069, 1072-1073 & nn. 3, 4 (8th Cir. 1984) (if an arbitration clause is narrow, the arbitrability determination requires inquiry into whether the claim is "on its face within the purview of the clause").

[14] *Cummings v. FedEx Ground*, 404 F.3d 1258, 1262 (10th Cir. 2005) ("When an arbitration clause is narrowly drawn, the policy in favor of arbitration does not have the 'strong effect here that it would have if we were construing a broad arbitration clause.' . . . Under a narrow arbitration clause, a dispute is subject to arbitration only if it relates to an issue that is on its face within the purview of the clause.") (citations omitted).

Court[15] have held that the presumption favoring arbitration is less applicable to a narrow arbitration clause than to a broad arbitration clause. Several of those courts have said that if the arbitration clause is narrow, a claim must *on its face* fall within the purview of the arbitration clause to require an order compelling arbitration of the claim.[16] Contrary to those decisions, the Fifth,[17] Eleventh,[18] and D.C. Circuit Courts of Appeal,[19] a district court in the

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[15] *Local Union No. 1710, Intern. Ass'n of Fire Fighters, AFL-CIO v. City of Chicopee*, 430 Mass. 417, 721 N.E.2d 378, 382 (1999) ("where the arbitration clause is not broad, courts must be *sure* that the parties contracted to arbitrate the issue at hand") (emphasis added).

[16] See, *e.g.*, the Second Circuit, Eighth Circuit, and Tenth Circuit decisions cited in footnotes 10, 13, and 14, *supra*.

[17] *Intern. Brotherhood of Elec. Workers, Local 2188 v. Western Electric Co., Inc.*, 661 F.2d 514, 516 n. 3 (5th Cir. 1981) ("[T]he [Supreme] Court has never indicated, in its statement of the rule, that the presumption [in favor of arbitration] is limited to such broad clauses. . . . Such a limitation would render the presumption of little value as a rule of construction: we would first have to determine that the arbitration clause is 'broad' enough to cover all contractual disputes, and only then apply the presumption (when it is no longer needed). Moreover, this court has consistently applied the presumption to arbitration clauses of varying breadth. . . . [I]n determining whether a dispute is within the confines of the arbitration clause, the presumption of arbitrability applies, regardless of whether one party characterizes the clause as 'narrow.' ") (citations omitted).

[18] *Ivax Corp. v. B. Braun of Am., Inc.*, 286 F.3d 1309, 1320 n. 23 (11th Cir. 2002) (rejecting argument that presumption in favor of arbitration applies only to broad arbitration clauses and does not apply to narrow arbitration clauses, stating that "the Court in *Moses Cone* made no such distinction, but rather, grounded its preference for arbitration in the "congressional declaration [in the FAA] of a liberal federal policy favoring arbitration agreements.").

[19] *Washington Mailers Union No. 29 v. Washington Post Co.*, 233 F.3d 587, 592 n. 4 (D.C. Cir. 2000) ("The Post argues that the presumption cases are inapplicable because they involve the construction of a 'broad' arbitration clause. We disagree. While the fact that the

(Continued on following page)

Ninth Circuit,[20] the Alaska Supreme Court,[21] and the Texas Supreme Court[22] draw no distinction between narrow and broad arbitration clauses in applying the presumption in favor of arbitration, holding that any doubts concerning arbitrability must be resolved in favor of arbitration, regardless of the scope of the clause. The New Jersey Supreme Court has taken note of the split among the circuits on the issue but held that the case before it did not require a decision on the issue.[23]

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arbitration clause in this case is not broad – limiting grievances to allegations of 'violation of a specific provision of this Agreement' – is relevant to our inquiry, it does not negate the presumption of arbitrability.") (citing *Western Electric*, 661 F.2d at 516 n. 3).

[20] *PNI, Inc. v. Leyton*, 2004 WL 555249, *3, 5 (D. Or. March 1, 2004) ("Whether the arbitration clause is broad or narrow . . . do[es] not answer the core question presented. In interpreting the . . . agreement, the court is guided by the well-established principle, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . .").

[21] *Lexington Marketing Group, Inc. v. Goldbelt Eagle, LLC*, 157 P.3d 470, 478 (Alaska 2007) (applying presumption in favor of arbitration, "regardless of whether the clause is narrow or broad.").

[22] *In re Dillard Dept. Stores*, 186 S.W.3d 514, 516 (Tex. 2006) (construing narrow arbitration clause to cover plaintiff's claims, stating that "[a] court should not deny arbitration 'unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue' . . . [and] the agreement is susceptible to an interpretation that includes Martinez's claim. Therefore, the trial court was required to compel arbitration.").

[23] *Camden Bd. of Educ. v. Alexander*, 181 N.J. 187, 854 A.2d 342 (2004). The majority opinion in this case said, "Although not necessary to our disposition, we mention only that several courts in jurisdictions that do apply the presumption in favor of arbitration from the 'Steelworkers Trilogy' have not applied the presumption to narrow arbitration clauses." 854 A.2d at 355 n. 10. The dissenting judge in this case would have held that the presumption in favor of arbitration applies to narrow clauses, stating: "Even if this arbitration clause is labeled 'narrow,' however, the presumption of arbitrability still applies. As the

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In this case, the New Mexico court of appeals adopted the Plaintiffs' argument that the presumption in favor of arbitration is of limited application to a narrow clause. App. 6, 8, 17-18. The court of appeals relied on an earlier New Mexico Supreme Court decision that held that "the arbitration agreement will be given broad interpretation *unless the parties themselves limit arbitration to specific areas or matters.*" App. 6, 8 (quoting *McMillan v. Allstate Indem. Co.*, 135 N.M. 17, 84 P.3d 65, 69 (N.M. 2003) (emphasis added)). The court of appeals also relied on one of the Tenth Circuit cases that has held that "[u]nder a narrow arbitration clause, a dispute is subject to arbitration only if it relates to an issue that is on its face within the purview of the clause." App. 17-18; *Cummings v. FedEx Ground Package Sys., Inc.*, 404 F.3d 1258, 1262 (10th Cir. 2005).

B. The Decision in This Case Illustrates the Error in a Restrictive Approach to the Application of the Presumption Favoring Arbitration to Narrow Arbitration Clauses.

The error in a restrictive approach to application of the presumption favoring arbitration to narrow arbitration clauses is fully illustrated by the New Mexico courts' disposition of Kinder Morgan's arbitration motion. Even though the court of appeals determined that the Plaintiffs'

Fifth Circuit has explained, applying the presumption of arbitrability only to broad arbitration clauses 'would render the presumption of little value as a rule of construction: we would first have to determine that the arbitration clause is "broad" enough to cover all contractual disputes, and only then apply the presumption (when it is no longer needed).'" 854 A.2d at 373 (Zazzali, J., dissenting) (quoting *Western Electric*, 661 F.2d at 516 n. 3).

Complaint could be reasonably construed to raise arbitrable claims, it denied arbitration of all claims and affirmed the trial court's denial of the motion to compel arbitration with regard to all claims. App. 10-19. The court of appeals reasoned that the limited application of the presumption favoring arbitration in the context of a narrow arbitration clause required that it deny arbitration unless and until it became "clear" that the claims in the Complaint were arbitrable. App. 17-18.

Specifically, the court of appeals noted that the Plaintiffs' allegations on their claim under the New Mexico Unfair Practices Act could be interpreted to allege claims regarding use of Non-Qualified contract prices that are arbitrable, but the court nevertheless denied arbitration, stating that the "Plaintiffs' allegations are very general" and "Plaintiffs' complaint simply does not make clear the facts they intend to prove at trial." App. 15-16. Similarly, on Plaintiffs' fraud claim, the court of appeals "note[d] . . . some language in the complaint [that] seems to indicate that Plaintiffs have decided to challenge the prices under non-qualified contracts" but concluded that "[i]t is unclear which facts Plaintiffs allege in support of this theory and which facts Plaintiffs allege in support of their claims for breach of the settlement agreement. . . ." App. 16. The court also noted that on the Plaintiffs' unjust enrichment claim, "Plaintiffs may indeed be challenging the prices under non-qualified contracts. It is simply not clear." App. 17.

The court ultimately held that "[h]aving concluded that nothing in the complaint *clearly* states whether the claims for violation of the Unfair Practices Act, fraud, and unjust enrichment are based on a dispute over non-qualified contract or transportation prices, . . . [and]

[a]pplying principles of contract interpretation, we conclude that it would be inappropriate to compel arbitration when we have not been able to determine that Plaintiffs raised any claims covered by the arbitration clause." App. 17 (emphasis added). The court "emphasize[d] that [its] decision [was] based on the *lack of clarity* in Plaintiffs' complaint and subsequent statements. . . ." App. 18 (emphasis added).

The manner in which the court resolved the arbitrability issues makes it clear that the court adopted a rule that resolves doubts in favor of court litigation, rather than arbitration. The court of appeals recognized that there were doubts concerning the arbitrability of the Plaintiffs' claims, but it nevertheless resolved those doubts by denying arbitration rather than ordering arbitration. The court of appeals' rationale for denying arbitration is directly contrary to the strong federal policy favoring arbitration that underlies the Federal Arbitration Act, as recognized by this Court in adopting the presumption favoring arbitration requiring that all doubts be resolved in favor of arbitration, not court litigation.

The fact that the court left open the possibility of a later order compelling arbitration of the Unfair Practices Act, fraud, and unjust enrichment claims if it "become[s] clear that prices of non-qualified contracts or transportation charges are issues with respect to" those claims (App. 18-19) does not prevent the impairment of Kinder Morgan's arbitration rights. The federal courts have recognized that "[a]rbitration loses much of its value if one party can force protracted litigation and expensive discovery. . . ." *Virginia Sprinkler Co. v. Local Union 669*, 868 F.2d 116, 121 (4th Cir. 1989). *See also Burton v. Bush*, 614 F.2d 389, 391 (4th Cir. 1980) ("We believe that . . .

[discovery] limitations [in arbitration] are in keeping with the policy underpinnings of arbitration – speed, efficiency, and reduction of litigation expenses"); *Metro East Center for Conditioning and Health v. Qwest Communications Intern., Inc.*, 294 F.3d 924, 927 (7th Cir. 2002) ("the discovery procedures of litigation may be more expensive for both sides than are the procedures used in arbitration"). By forcing Kinder Morgan to engage in expensive court discovery with regard to claims that should be referred to arbitration under the proper application of the presumption favoring arbitration, the court of appeals has deprived Kinder Morgan of one of the significant benefits of the arbitration clause in the Settlement Agreement.

In summary, this case is an appropriate case for resolving the significant conflict in the decisions of the United States Courts of Appeals and the state supreme courts concerning the proper application of the presumption favoring arbitration in the context of narrow arbitration clauses.

II. The New Mexico Court of Appeals' Denial of Arbitration Based on the "Lack of Clarity" in the Plaintiffs' Complaint Conflicts with Circuit Court of Appeals and District Court Decisions That Refuse to Allow Arbitration Rights to be Defeated Based on Vague or Artful Pleadings.

As discussed above, the New Mexico court of appeals denied arbitration of some of Plaintiffs' claims only because the Plaintiffs' allegations were "general" and "not clear." App. 14-19. The court did not mince words on that conclusion: "We emphasize that our decision is based on

the lack of clarity in Plaintiffs' complaint and subsequent statements. . . ." App. 18.

Unlike the court of appeals in this case, the federal courts uniformly held that a court should not deny arbitration based on a plaintiff's artful pleading or on doubts concerning arbitrability raised by vague allegations in a plaintiff's complaint. *See Brandon, Jones, Sandall, Zeide, Kohn, Chalal & Musso, P.A. v. MedPartners, Inc.*, 312 F.3d 1349, 1358 (11th Cir. 2002) (court compelled arbitration, stating that "[t]o conclude otherwise would allow [plaintiff] to avoid arbitration simply through artful pleading"); *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, 1360 (2d Cir. 1993) ("We refuse to allow a party's solemn promise [in forum selection and arbitration clauses] to be defeated by artful pleading"); *Ivax Corp.*, 286 F.3d at 1318 ("surely parties to an arbitration agreement may not 'evade arbitration through artful pleading' "); *Encore Produc., Inc. v. Promise Keepers*, 53 F.Supp.2d 1101, 1110 (D. Colo. 1999) (though complaint was ambiguous as to arbitrability of claim, arbitration was compelled because "federal policy construes all ambiguities in favor of arbitration"); *Land v. Dean Witter Reynolds, Inc.*, 617 F.Supp. 52, 55 (E. D. Va. 1985) (court compelled arbitration of claim alleged in "vague and conclusory terms," stating that "[a]fter the details of this claim have been fleshed out in arbitration, this count may be referred back to this Court for resolution should the arbitrator determine that this claim is not arbitrable"). The New Mexico court of appeals' denial of arbitration based on the "lack of clarity in Plaintiffs' complaint" directly conflicts with these decisions and will have the effect of exposing defendants in New Mexico (and perhaps other state courts that choose to follow the approach of the New Mexico court of appeals in this reported

decision) to loss of their arbitration rights solely as a result of a plaintiff's vague or artful pleading. Review of this important issue is warranted.

III. Plaintiffs' Characterization of Their Claims as "Breach" Claims Is Not Dispositive of Arbitrability, and the New Mexico Court of Appeals' Decision to the Contrary Conflicts With Decisions of the Fourth and Seventh Circuits.

The court of appeals acknowledged that the contract claims that the Plaintiffs assert in this case are claims regarding Non-Qualified prices that Kinder Morgan used in the calculation of royalties.[24] The court repeatedly said that the Plaintiffs' claims relating to the methodology used to calculate royalties arose out of Kinder Morgan's use of Non-Qualified prices in the calculations.[25] The court also recognized that the Plaintiffs allege that Kinder Morgan failed to contract for "the best price reasonably available" when it entered into contracts for the sale of carbon dioxide produced at the Unit.[26] Having become a working interest owner after the execution of the Settlement Agreement, any such contracts entered into by Kinder Morgan necessarily are Non-Qualified contracts under the

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[24] See App. 4 ("Plaintiffs contend that Kinder Morgan modified the parties' agreed-on methodology for calculating future royalties, by using non-qualified contracts in the royalty calculations. . . ."); App. 5 ("Plaintiffs also argue that the use of non-qualified contracts in calculating royalty payments is in itself a breach of the settlement agreement. . . ."); App. 12 ("Plaintiffs argue that the use of non-qualified contracts in itself constitutes a breach of the settlement agreement.").

[25] *Id.*

[26] *Id.* at 13.

Settlement Agreement, and the Plaintiffs' claims challenging the prices under those contracts are claims regarding Non-Qualified prices. Those claims are precisely the type of claims that the arbitration clause was intended to cover.

Nevertheless, the Plaintiffs characterized their claims as claims for "breach" of the Settlement Agreement, and they argued to the court of appeals that because of that characterization, the claims fall within the exclusionary clause in the arbitration agreement for "future claims for breach of this Agreement." In response, Kinder Morgan pointed out that the Plaintiffs' proposed interpretation of the exclusionary clause left no disputes regarding the calculation of royalties arbitrable, because the Plaintiffs characterized any use of Non-Qualified prices in the royalty calculations as a "breach" falling within the exclusionary clause. Kinder Morgan offered a narrower interpretation of the exclusionary clause, which is described in the Statement of the Case section of this Petition. Under that interpretation, the "claims for breach of this Agreement" referenced in the exclusionary clause in the last sentence of Section 16 relates to claims for breach of the provisions in the Settlement Agreement that prohibited the use of certain types of deductions in the royalty calculations, such as those found in Sections 9.2, 10, 11.2, and 11.4, but would not include claims based on the use of Non-Qualified prices and charges falling outside those prohibitions, as the parties stipulated that they were "omit[ting] any agreement" with regard to the use of such prices and charges in Section 14(c) of the Settlement Agreement. The parties, having stipulated in the Settlement Agreement that they were "omit[ting] any agreement" concerning the use of Non-Qualified prices, could not have intended that the use of such prices would constitute a "breach" of the

Settlement Agreement for the purposes of the exclusionary clause in the last sentence of the arbitration agreement in Section 16.

The court of appeals did not address that narrower interpretation of the exclusionary clause. Instead, the court held that the Plaintiffs' characterization of its claims as "claims for breach" was controlling on the arbitrability determination. The court said that "when, as here, the arbitration clause has an explicit exception for certain types of claims, we must consider the causes of action Plaintiffs rely on." App. 10. The court noted that "Plaintiffs argue that the use of non-qualified contracts in itself constitutes a breach of the settlement agreement," that the third count in the Complaint "alleges breach of the settlement agreement," and "[i]t therefore, is not subject to arbitration." App. 12-13. With regard to the fourth count in the Complaint, alleging failure to obtain the best price reasonably available, the court noted that Plaintiffs "allege breach of the settlement agreement" and held that therefore, "[t]his claim, as stated in Plaintiffs' complaint, is not subject to arbitration." App. 13. The court made no inquiry to determine whether the nature of the claim was of the type that the parties intended to exclude from arbitration, but found the Plaintiffs' characterization of the claims as "claims for breach" to be determinative.

This approach to determining arbitrability conflicts with decisions of the Seventh and Fourth Circuits. In *In re Oil Spill by Amoco Cadiz*, 659 F.2d 789, 794 (7th Cir. 1981) the Seventh Circuit rejected the plaintiff's argument that arbitrability should turn on the plaintiff's characterization of its claims, stating that "[w]hether a particular claim is arbitrable depends not upon the characterization of the claim, but upon the relationship of the claim to the

subject matter of the arbitration clause. Were the rule otherwise, a party could frustrate any agreement to arbitrate simply by the manner in which it framed its claims." Similarly, the Fourth Circuit has said that in determining arbitrability, a court "must determine whether the factual allegations underlying the claim are within the scope of the arbitration clause, *regardless of the legal label assigned to the claim*." *J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, 319 (4th Cir. 1988) (emphasis added). The court of appeals in this case applied a contrary rule. Because the court of appeals has announced a rule relating to the determination of arbitrability that conflicts with the rules announced in the Seventh Circuit's decision in *Amoco Cadiz* and the Fourth Circuit's decision in *J.J. Ryan*, review is warranted.

IV. The New Mexico Court of Appeals Failed to Construe the Exclusionary Clause in the Settlement Agreement Narrowly, Contrary to Fourth Circuit Precedent.

The court of appeals' approach to the interpretation of an exclusionary clause in an arbitration agreement directly conflicts with the Fourth Circuit's approach to that same issue in *Choice Hotels Intern. Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707, 711 (4th Cir. 2001). In *Choice Hotels*, the exclusionary clause excluded from arbitration "actions for the collection of money owed under this Agreement." 252 F.3d at 710. The plaintiff argued that this exclusionary clause covered all claims seeking monetary damages. *Id.* at 711. While recognizing that the plaintiff's broad interpretation was plausible, the Fourth Circuit adopted a narrow construction of the language, limiting the exclusion to "traditional collection actions." *Id.* In so

holding, the court relied on (1) the "federal policy requir[ing] that ambiguities in arbitration clauses be resolved in favor of arbitration," (2) the rule that the "policy favoring broad construction of arbitration clauses compels narrow construction of exceptions to arbitration clauses," and (3) the rule requiring that exceptions to arbitration be narrowly construed "lest they overwhelm the rule." *Id.* The Fourth Circuit noted that under the plaintiff's interpretation, no claims for money under the contract would be arbitrable, even though the description of arbitrable claims (considered without reference to the exclusion) clearly included such claims. *Id.*

The court of appeals in this case took precisely the opposite approach to construction of the exclusionary clause. The court of appeals ignored Kinder Morgan's proposed narrower interpretation of the exclusionary clause, *i.e.*, that the exclusion for "future claims for breach of this Agreement" referred to claims for violation of the prohibitions on use of certain types of charges in the calculations. Kinder Morgan presented a reasonable, narrower interpretation of the exclusionary clause, but the New Mexico court of appeals ignored that interpretation and instead, it interpreted the exclusionary clause as broadly as possible. The court of appeals' interpretation of the exclusionary clause results in the exclusionary clause overwhelming the arbitration clause, leaving no disputes regarding the calculation of the royalties arbitrable, precisely the result that the Fourth Circuit found improper in *Choice Hotels*.

This issue and the other issues that this petition raises flow from the court of appeals' refusal to broadly apply the presumption favoring arbitration to the arbitration clause in the Settlement Agreement. Review of this

case is warranted to eliminate the confusion that currently exists in the United States Court of Appeals and the state courts over the proper application of the presumption favoring arbitration in determining arbitrability under a narrow arbitration clause and to avoid the impairment of arbitration rights that will occur if arbitrability decisions are allowed to turn on a plaintiff's vague and artful pleading and its unilateral characterization of its claims.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN B. POUND
LONG, POUND & KOMER, P.A.
2200 Brothers Road
P.O. Box 5098
Santa Fe, NM 87502-5098
(505) 982-8405

GUY S. LIPE
Counsel of Record
VINSON & ELKINS L.L.P.
2500 First City Tower
1001 Fannin
Houston, TX 77002-6760
(713) 758-1109

Counsel for Petitioner Kinder Morgan CO_2 Company, L.P.

144 P.3d 111

Court of Appeals of New Mexico.
J. Casper **HEIMANN**, Pecos Slope Royalty Trust and Rio Petro Ltd., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated, Plaintiffs-Appellees,
v.
KINDER-MORGAN CO2 COMPANY, L.P., Defendant-Appellant.
No. 25,735.

Aug. 8, 2006.
Certiorari Granted, No. 29,990, Oct. 11, 2006.

Gallegos Law Firm, P.C., J.E. Gallegos, Michael J. Condon, Santa Fe, NM, Susman Godfrey, LLC, Thomas W. Paterson, Shawn Raymond, Houston, TX, for Appellees.

Long, Pound & Komer, P.A., John B. Pound, Santa Fe, NM, Vinson & Elkins L.L.P., Guy S. Lipe, Andrew McCollam, III, Richard H. Page, Houston, TX, for Appellant.

OPINION

WECHSLER, Judge.

{1} In this case we determine the scope of an arbitration clause contained in a 1998 settlement agreement between Plaintiffs, a class of carbon dioxide royalty owners, and Defendant, Kinder Morgan CO2 Company, L.P., a working interest owner. Kinder Morgan appeals a district court order denying its motion to compel arbitration. We entertain this appeal pursuant to NMSA 1978, § 44-7-19(A)(1) (1971) (repealed 2001) (current version at NMSA 1978, § 44-7A-29(a)(1) (2001)), and we affirm.

BACKGROUND

{2} Plaintiffs own royalties in the Bravo Dome Carbon Dioxide Unit, a carbon dioxide producing unit in northeastern New Mexico, based on their fee ownership of the land. Carbon dioxide is transported by Kinder Morgan from the Unit to oil fields, where it is used to aid in the production of oil. Kinder Morgan uses some of the carbon dioxide it produces at the Unit in its own oil operations and sells the rest to other oil companies. It pays royalties to Plaintiffs based on the sales for the carbon dioxide it produces at the Unit.

{3} In 1995, Plaintiffs filed a lawsuit against the Unit's carbon dioxide producers, including Shell Western E & P Inc. and Shell CO2 Company, Kinder Morgan's predecessors-in-interest, for royalties they claimed had been underpaid. Plaintiffs and Shell settled the lawsuit in 1998. Plaintiffs filed this lawsuit against Kinder Morgan in August 2004, claiming violations of the Unfair Practices Act, constructive fraud, breach of the settlement agreement, breach of the implied covenant of good faith, breach of a covenant to market, and unjust enrichment, and requesting an accounting, injunctive relief, compensatory and punitive damages, interest, and attorney fees and costs. In its answer and a subsequent motion to compel arbitration, Kinder Morgan argued that each of these claims was subject to an arbitration clause contained in the 1998 settlement agreement. The parties agree that the arbitration clause is valid, but dispute its proper scope.

{4} The 1998 settlement agreement contained numerous provisions governing the method by which future royalties would be calculated. It provided that Shell would pay royalties based on "the volume weighted average of the

prices for [its] sales or other dispositions of Unit CO2 that [it] separately dispose[s] of or take[s] in kind." This volume weighted average would be calculated "utilizing a net-back methodology to adjust [Shell's] prices for sales or other dispositions occurring downstream of the Unit Tailgate, and utilizing the prices or values established in [its] Qualified Contracts . . . , [its] transportation charges established as Qualified Other Transportation Charges . . . , and [its] Approved Mainline Deductions." The settlement agreement further provided that other methodology might be used:

> Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or approved herein, or that future royalty payments resulting from the use of such benchmarks, are improper. [Shell], on the one hand, and Plaintiffs and members of the Class, on the other, intend, only, to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper.

(5) The arbitration clause in the settlement agreement applies to disputes involving non-qualified contracts and non-qualified transportation charges. "Non-qualified" contracts and charges, as defined by the settlement agreement, are new contracts or arrangements not pre-approved by the royalty owners. The arbitration clause states:

> Any claims asserted by Plaintiffs or members of the Class against . . . Shell regarding (a) the price or value under Non-Qualified Contracts . . . utilized by . . . Shell in establishing royalty settlement values for purposes of payment to their

> Respective Owners and, (b) regarding Non-Qualified Other Transportation Charges . . . utilized by . . . Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding arbitration. . . . This provision concerning arbitration applies only to the claims identified in this paragraph . . . and shall, in no event, apply to any future claims for breach of this Agreement.

{6} Kinder Morgan filed a motion to compel arbitration on each issue in this case. At a hearing on February 24, 2005, the district court ruled that the claims alleged involved breach of contract and were therefore not subject to the arbitration clause. It entered an order denying Kinder Morgan's motion in March 2005.

ARGUMENTS ON APPEAL

{7} Kinder Morgan argues that the district court erred in denying its motion to compel arbitration. Because Plaintiffs contend that Kinder Morgan modified the parties' agreed-on methodology for calculating future royalties, by using non-qualified contracts in the royalty calculations and by failing to disclose that use to Plaintiffs, Kinder Morgan argues that underlying Plaintiffs' claims is the contention that the price of non-qualified contracts was improper. Thus, according to Kinder Morgan, all of Plaintiffs' claims are subject to arbitration. Although the complaint is largely couched in terms of breach of contract, it also contains language that Kinder Morgan argues shows that the claims fall within the scope of the arbitration clause, such as the following:

> 10. . . . The defendant has engaged in across the board methods of fabricating prices and fixing self serving false values for the Unit CO2. . . .
>
> . . . .
>
> 25. . . . Small quantities of the CO2 from the Unit are some times [sic] the subject of pretextual "bid" arrangements resulting in a sales contract reciting a "price" per Mcf of CO2 delivered at a Permian Basin oil field. Some Unit working interest owners have cited such "prices" as a basis for valuing CO2 produced at the Unit. . . .
>
> . . . .
>
> 43. Kinder-Morgan has for the material time uniformally [sic] set "prices" that are not formed by true market forces, are grossly less than the value relative to the oil and other hydrocarbons that but for the CO2 would not be recovered and are fixed by the defendant to serve its objectives of (a) reducing expense and (b) maximizing its profit. . . .

Kinder Morgan correctly notes that ambiguity in arbitration clauses should be resolved to favor arbitration. *E.g., DeArmond v. Halliburton Energy Servs., Inc.*, 2003-NMCA-148, ¶ 7, 134 N.M. 630, 81 P.3d 573.

{8} Plaintiffs argue that in order to invoke the arbitration clause, Kinder Morgan must give prior notice of its intention to use non-qualified contracts in its royalty calculation. Their contention is that once notice had been given, and royalty owners had objected, Kinder Morgan could then have invoked the arbitration clause. Plaintiffs also argue that the use of non-qualified contracts in calculating royalty payments is in itself a breach of the settlement agreement that would fit within the explicit exception to

the arbitration clause for claims for breach of the settlement agreement. Thus, they argue, none of their claims is subject to arbitration. Finally, Plaintiffs note that the arbitration clause is narrow and should not be bound by the general policy in favor of arbitrability. *See, e.g., New York v. Oneida Indian Nation of N.Y.,* 90 F.3d 58, 61-63 (2d Cir.1996).

STANDARD OF REVIEW

{9} We review de novo the district court's denial of Kinder Morgan's arbitration demand. *Piano v. Premier Distrib. Co.,* 2005-NMCA-018, ¶ 4, 137 N.M. 57, 107 P.3d 11. Interpretation of the arbitration clause in the settlement agreement is also a question of law subject to de novo review. *W. Farm Bureau Ins. Co. v. Carter,* 1999-NMSC-012, ¶ 4, 127 N.M. 186, 979 P.2d 231.

ARBITRATION

{10} We first address the parties' claims and note that both seem to have taken somewhat unreasonable positions. On the one hand, Kinder Morgan's position would require arbitration of all claims that involve non-qualified contracts or transportation charges. Its interpretation of the arbitration agreement would leave essentially no viable claims that would not be subject to arbitration, despite the fact that the arbitration clause is narrow and explicitly excludes claims for breach of the settlement agreement. On the other hand, Plaintiffs' position allows arbitration only when Kinder Morgan has followed specific procedures that do not appear within the settlement agreement. We will not read language into a contract that is not there, but neither will we construe any clause so as

to render it meaningless. *See Pub. Serv. Co. of N.M. v. Diamond D Constr. Co.*, 2001-NMCA-082, ¶ 31, 131 N.M. 100, 33 P.3d 651; *cf. Twin Forks Ranch, Inc. v. Brooks*, 1998-NMCA-129, ¶ 20, 125 N.M. 674, 964 P.2d 838 (noting that courts cannot reform a contract to add terms not agreed upon by the parties). We accordingly reject both parties' positions.

{11} The parties agree that we ought not look beyond the language of the complaint to determine whether Plaintiffs' claims are subject to arbitration. However, both parties present arguments on appeal that are based on statements made subsequent to the filing of the complaint. We reach the same conclusion regardless of whether we consider these statements.

{12} Despite Kinder Morgan's suggestion that the claim for breach of the settlement agreement is not legitimate, we will not consider the validity of claims stated.

> [I]n deciding whether the parties have agreed to submit a particular grievance to arbitration, a court is not to rule on the potential merits of the underlying claims. Whether "arguable" or not, indeed even if it appears to the court to be frivolous, the . . . claim . . . is to be decided, not by the court asked to order arbitration, but as the parties have agreed, by the arbitrator. "The courts, therefore, have no business weighing the merits of the grievance, considering whether there is equity in a particular claim, or determining whether there is particular language in the written instrument which will support the claim. The agreement is to submit all grievances to arbitration, not merely those which the court will deem meritorious."

AT & T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 649-50, 106 S.Ct. 1415, 89 L.Ed.2d 648 (1986) (citation omitted). Thus, we decline to express any opinion as to the merits of Plaintiffs' claims as stated. This issue is not before us.

{13} Both the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2000), and the New Mexico Uniform Arbitration Act, NMSA 1978, §§ 44-7-1 to -22 (1971) (repealed 2001) (current version at NMSA 1978, §§ 44-7A-1 to -32 (2001)), express a strong presumption in favor of arbitrability. *See, e.g., McMillan v. Allstate Indem. Co.*, 2004-NMSC-002, ¶ 9, 135 N.M. 17, 84 P.3d 65; *Heye v. Am. Golf Corp.*, 2003-NMCA-138, ¶ 8, 134 N.M. 558, 80 P.3d 495. However, we agree with Plaintiffs that only matters falling under the scope of a narrow arbitration clause require arbitration. *See McMillan*, 2004-NMSC-002, ¶ 10, 135 N.M. 17, 84 P.3d 65 ("[T]he arbitration agreement will be given broad interpretation unless the parties themselves limit arbitration to specific areas or matters.") (internal quotation marks and citation omitted); *cf. AT & T Techs., Inc.*, 475 U.S. at 650, 106 S.Ct. 1415 (noting that the presumption in favor of arbitration, the rule that "[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute," is "particularly applicable" when the arbitration clause at issue is broad) (alteration in original) (internal quotation marks and citation omitted). The presumption does not operate to create a right to arbitrate claims the parties have not agreed to arbitrate. *See Santa Fe Techs., Inc. v. Argus Networks, Inc.*, 2002-NMCA-030, ¶¶ 52-57, 131 N.M. 772, 42 P.3d 1221 (noting that "the court's inquiry is whether the parties have agreed to

arbitrate the matter under dispute" and holding that the arbitration clause in that case, though broad, was not broad enough to encompass the claim); *see also AT & T Techs., Inc.,* 475 U.S. at 648-49, 106 S.Ct. 1415 ("[A]rbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration."). We "give effect to the intent of the parties, and when the terms of the agreement are clear and unambiguous, courts try to ascertain the intent of the parties from the ordinary meaning of the language in the agreement." *Cont'l Potash, Inc. v. Freeport-McMoran, Inc.,* 115 N.M. 690, 704, 858 P.2d 66, 80 (1993).

{14} Under the arbitration clause in this case, the parties agreed to submit to arbitration only those claims regarding the prices of non-qualified contracts and transportation charges. Language in the settlement agreement emphasizes the narrow scope of the arbitration clause: "This provision concerning arbitration applies only to the claims identified in this paragraph. . . ." It also provides an explicit exception for "any future claims for breach of this Agreement." "Courts must interpret the provisions of an arbitration agreement according to the rules of contract law and apply the plain meaning of the contract language in order to give effect to the parties' agreement." *McMillan,* 2004-NMSC-002, ¶ 10, 135 N.M. 17, 84 P.3d 65. We therefore turn first to the question of breach of the settlement agreement, because claims for breach are not subject to arbitration regardless of whether they may involve prices of non-qualified contracts. Then, we will discuss whether other claims in the complaint should be subject to the arbitration clause.

EXCEPTION FOR BREACH OF THE SETTLEMENT AGREEMENT

{15} Ordinarily we look to the facts alleged in a complaint to determine whether claims are subject to arbitration. *See Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 846 (2d Cir.1987) ("In determining whether a particular claim falls within the scope of the parties' arbitration agreement, we focus on the factual allegations in the complaint rather than the legal causes of action asserted."). But when, as here, the arbitration clause has an explicit exception for certain types of claims, we must consider the causes of action Plaintiffs rely on. The settlement agreement states that no claims for breach of the settlement agreement are subject to arbitration, and we must examine the complaint to give effect to the intent of the parties. *See Shaeffer v. Kelton*, 95 N.M. 182, 185, 619 P.2d 1226, 1229 (1980) ("The primary objective in construing a contract is not to label it with specific definitions or to look at form above substance, but to ascertain and enforce the intent of the parties as shown by the contents of the instrument."). Claims for breach of contract are necessarily claims for breach of the settlement agreement, because that agreement is the only contract between the parties. We therefore examine the facts underlying each of Plaintiffs' claims to determine what claim, if any, they state, and whether that claim falls within the exception.

{16} Plaintiffs' first claim alleges violation of New Mexico's Unfair Practices Act. NMSA 1978, §§ 57-12-1 to -24 (1967, as amended through 2005). In order to state a claim for unconscionable trade practices, a plaintiff may allege that the defendant took advantage of the plaintiff's "lack of knowledge . . . to a grossly unfair degree" to the plaintiff's detriment, or that action of the defendant "result[ed]

in a gross disparity between the value received by [the plaintiff] and the price paid." Section 57-12-2(E). Plaintiffs' complaint alleges that Kinder Morgan "has taken advantage of the lack of knowledge of the plaintiffs to a grossly unfair degree and paid the Royalty Interests in an amount grossly less than the proper and real value." Plaintiffs must also allege that this practice occurred "in connection with the sale, lease, rental or loan, or in connection with the offering for sale, lease, rental or loan, of any goods or services." *Id.* As we have noted, the entire complaint arises from the lease and sale of carbon dioxide. Violation of the Act is not a breach of contract, as evidenced by Section 57-12-10(D), which provides for relief "in addition to remedies otherwise available." This claim does not, therefore, fit within the explicit exclusion for claims of breach of the settlement agreement.

{17} Plaintiffs' complaint next alleges fraud. To state a claim for fraud, plaintiffs must allege

> that a representation was made as a statement of fact which was untrue and known to be untrue by the party making it, or else recklessly made; that it was made with intent to deceive and for the purpose of inducing the other party to act upon it; and that the other party did in fact rely on it and was induced thereby to act to his injury or damage.

Sauter v. St. Michael's Coll., 70 N.M. 380, 384-85, 374 P.2d 134, 138 (1962). Fraud may also be premised on an omission if there is a duty to disclose information, such as when the defendant has superior knowledge. *Azar v. Prudential Ins. Co. of Am.*, 2003-NMCA-062, ¶ 60, 133 N.M. 669, 68 P.3d 909. Plaintiffs allege fraud by claiming that Kinder Morgan had "superior and important knowledge concerning

the CO2 economics and uses available only to it," that Kinder Morgan failed to "disclose completely and truthfully all material facts," that Kinder Morgan did so intentionally, and that Kinder Morgan's failure to disclose "has proximately caused damages to the plaintiffs." Fraud is a tort, rather than a breach of contract, claim and is therefore potentially subject to the arbitration agreement. *See Williams v. Stewart,* 2005-NMCA-061, ¶ 36, 137 N.M. 420, 112 P.3d 281 (noting and distinguishing "breach of contract" and "the tort of fraud" as two separate causes of action).

{18} The complaint alleges "breach of contract and of the covenant of good faith and fair dealing" as its third claim. We turn to the facts alleged to determine whether this claim is actually for breach of the settlement agreement, and conclude that it is. The claim of breach of good faith and fair dealing sounds in contract, at least when no "special relationship" such as that between an insured and insurer exists. *Bourgeous v. Horizon Healthcare Corp.,* 117 N.M. 434, 439, 872 P.2d 852, 857 (1994). This concept allows courts to award damages for breach of contract when one party prevents another from getting the benefits of a contractual arrangement. *Id.* at 438, 872 P.2d at 856. Plaintiffs' complaint alleges that Kinder Morgan interfered with their right to payment under the settlement agreement insofar as Kinder Morgan "intentionally to cause damage" calculated royalty payments using prices that are "not formed by true market forces." On appeal, Plaintiffs argue that the use of non-qualified contracts in itself constitutes a breach of the settlement agreement. We reiterate that it is not our task to decide the merits of this claim, but rather to determine whether it falls within the exception to the arbitration clause in the settlement

agreement. As stated in the complaint and on appeal, Plaintiffs' third claim alleges breach of the settlement agreement. It, therefore, is not subject to arbitration.

{19} Plaintiffs' fourth claim is for breach of an implied covenant to market. Implied covenants are enforced by courts when "it is clear . . . from the relevant parts of the contract taken together and considered with the facts and circumstances surrounding the execution of the agreement, that the obligation in question was within the contemplation of the parties or was necessary to effect their intention." *Cont'l Potash, Inc.,* 115 N.M. at 704, 858 P.2d at 80; *see Darr v. Eldridge,* 66 N.M. 260, 264, 346 P.2d 1041, 1044 (1959) (noting that "equity demands that the covenant to market be implied in oil and gas leases"). Plaintiffs allege that Kinder Morgan is subject to an implied covenant "to achieve the best price or value for CO2 produced from the Unit reasonably possible under the circumstances." They further allege that Kinder Morgan breached that covenant by failing to "derive the best prices reasonably available." Plaintiffs thus allege breach of the settlement agreement in their fourth claim. This claim, as stated in Plaintiffs' complaint, is not subject to arbitration.

{20} The fifth claim in Plaintiffs' complaint requests an accounting, an injunction, and damages for unjust enrichment. An accounting and an injunction are remedies only and do not constitute independent claims for the purpose of this analysis. Unjust enrichment, however, is a theory under which an aggrieved party may recover from another party who has profited at the expense of the aggrieved party. *Ontiveros Insulation Co. v. Sanchez,* 2000-NMCA-051, ¶ 11, 129 N.M. 200, 3 P.3d 695. In order to state a claim for unjust enrichment, the aggrieved party must allege "that: (1) another has been knowingly benefitted at

one's expense (2) in a manner such that allowance of the other to retain the benefit would be unjust." *Id.* Plaintiffs in this case allege unjust enrichment by claiming that Kinder Morgan "has willfully and in violation of duties imposed by law and equity failed and continues to fail to fairly share the true economic benefit of the CO2 produced from the Unit." However, it is not clear whether a claim for unjust enrichment is a claim for breach of the settlement agreement that is excluded from the arbitration requirement. Our Supreme Court has said that "an action for unjust enrichment is not 'based on contract' in a strict theoretical sense," but that it is sufficiently closely related to a contract claim that it ought to be subject to the same sovereign immunity requirements. *Hydro Conduit Corp. v. Kemble,* 110 N.M. 173, 179, 793 P.2d 855, 861 (1990); *see also Tom Growney Equip., Inc. v. Ansley,* 119 N.M. 110, 112, 888 P.2d 992, 994 (Ct.App.1994) ("New Mexico has recognized a theory of quantum meruit distinct from contract."). We agree that unjust enrichment is much like a contract claim, but we decline to hold that it fits within the arbitration clause's exception because the settlement agreement is not clear on this point and we resolve ambiguity in favor of arbitration. *See McMillan,* 2004-NMSC-002, ¶ 9, 135 N.M. 17, 84 P.3d 65.

SCOPE OF THE ARBITRATION CLAUSE

{21} Because we conclude that Plaintiffs' claims for violation of the Unfair Practices Act, fraud, and unjust enrichment do not fit within the settlement agreement's exception to its arbitration clause, we must determine whether they are claims "regarding (a) the price or value under Non-Qualified Contracts . . . [or] (b) regarding Non-Qualified Other Transportation Charges." As we have

noted, the arbitration provision in this case is narrow because it only applies to claims regarding non-qualified contract prices and transportation charges and "shall, in no event, apply to any future claims for breach of this Agreement." Because the clause is narrow, our usual presumption in favor of arbitration will not resolve the issue. *Cf. Heye,* 2003-NMCA-138, ¶ 8, 134 N.M. 558, 80 P.3d 495 (noting that the presumption in favor of arbitration does not apply when the parties dispute the validity of an agreement to arbitrate). We review the factual allegations underlying these claims, bearing in mind the clearly expressed intent of the parties in agreeing to arbitration. *See Shaeffer,* 95 N.M. at 185, 619 P.2d at 1229.

{22} First, we examine Plaintiffs' claim for violation of the Unfair Practices Act. The complaint alleges several facts relevant to this claim. Plaintiffs allege that Kinder Morgan "made false or misleading statements" and that those statements misled Plaintiffs as to "the value of Unit CO2." Plaintiffs further allege that Kinder Morgan paid them "an amount grossly less than the proper and real value." Kinder Morgan has argued that this claim is about prices under non-qualified contracts. It is true that one way Kinder Morgan could have paid Plaintiffs "less than the proper and real value" is by using the calculation method provided by the settlement agreement, but including improperly valued non-qualified contracts in the average. Plaintiffs do allege, for example, that Kinder Morgan engaged in "pretextual 'bid' arrangements" that reduced the price paid under non-qualified contracts. However, Plaintiffs' allegations are very general. They indicate that the royalties they were paid were too low, but that they have limited information, including "a supposed per well production volume." This reference may indicate

that Plaintiffs intend to prove that Kinder Morgan paid royalties that were too low not because it was using improperly valued non-qualified contracts, but rather, for example, because it deceived Plaintiffs about the amount of carbon dioxide produced. Plaintiffs' complaint simply does not make clear the facts they intend to prove at trial. We note that Plaintiffs' later statements also do not make clear the facts Plaintiffs intend to prove.

[23] Plaintiffs' second claim, for fraud, is likewise framed in general terms. The complaint alleges that Kinder Morgan engaged in a "value reducing scheme" but does not make clear the nature of this "scheme" and does not state the facts Plaintiffs intend to prove at trial. We note, as did Kinder Morgan, that some language in the complaint seems to indicate that Plaintiffs have decided to challenge the prices under non-qualified contracts. But none of this language appears within the section of Plaintiffs' complaint that alleges fraud. And, as noted in the previous paragraph, some language in the general "facts" section of the complaint indicates that Plaintiffs may intend to prove other facts entirely. It is unclear which facts Plaintiffs allege in support of this theory and which facts Plaintiffs allege in support of their claims for breach of the settlement agreement because Plaintiffs have grouped most of their factual allegations together in their complaint.

[24] Finally, we examine Plaintiffs' claim for unjust enrichment. The complaint alleges that Kinder Morgan has been enriched by virtue of "devices and payment methods which have and do deprive plaintiffs and the class members of their proper ... entitlement." Once again, Plaintiffs do not appear to be relying on the prices under non-qualified contracts. Instead, they seem to dispute the method as a whole by which Kinder Morgan

calculated royalty payments. It may be that Plaintiffs can prove at trial that Kinder Morgan's payments were improper notwithstanding that the prices under non-qualified contracts were adequate. However, we agree with Kinder Morgan that Plaintiffs may indeed be challenging the prices under non-qualified contracts. It is simply not clear.

{25} Having concluded that nothing in the complaint clearly states whether the claims for violation of the Unfair Practices Act, fraud, and unjust enrichment are based on a dispute over non-qualified contract or transportation prices, we must now determine whether the district court erred by not sending these claims to arbitration. Applying principles of contract interpretation, we conclude that it would be inappropriate to compel arbitration when we have not been able to determine that Plaintiffs raised any claims covered by the arbitration clause. *See AT & T Techs., Inc.,* 475 U.S. at 648, 106 S.Ct. 1415 ("[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.") (internal quotation marks and citation omitted); *cf. McMillan,* 2004-NMSC-002, ¶ 10, 135 N.M. 17, 84 P.3d 65 (noting that "New Mexico public policy favors freedom to contract" and that, therefore, the limitations in an arbitration clause "must be enforced" unless they violate law or public policy); *Santa Fe Techs., Inc.,* 2002-NMCA-030, ¶ 55, 131 N.M. 772, 42 P.3d 1221 (noting that some arbitration clauses "are drafted with broad strokes and, as a result, require broad interpretation" but that even broad arbitration clauses may be limited in scope). The presumption in favor of arbitration cannot operate to compel arbitration of a particular claim in the absence of an agreement to arbitrate a particular claim.

See Santa Fe Techs., Inc., 2002-NMCA-030, ¶ 52, 131 N.M. 772, 42 P.3d 1221 ("[T]he Court's inquiry is whether the parties have agreed to arbitrate the matter under dispute."); *see also Cummings v. FedEx Ground Package Sys., Inc.*, 404 F.3d 1258, 1262 (10th Cir.2005) ("In construing the scope of a narrow arbitration clause, we must take care to carry out the specific and limited intent of parties."). Given the narrow scope of the arbitration agreement in this case, it is inappropriate to compel arbitration when Plaintiffs may not dispute the prices under non-qualified contracts at all.

CONCLUSION

{26} We emphasize that our decision is based on the lack of clarity in Plaintiffs' complaint and subsequent statements rather than on any perceived ambiguity in the arbitration agreement itself. We attempt to give effect to the intent of the parties as expressed in their agreement, but the structure of the arbitration clause necessitates careful consideration of the manner in which Plaintiffs structured their complaint. *See Cont'l Potash, Inc.*, 115 N.M. at 704, 858 P.2d at 80. Plaintiffs have chosen to group the facts they allege at the beginning of their complaint and it is therefore impossible at this point to determine which facts they intend to prove to establish each claim. Because it is not clear whether Plaintiffs challenge the prices under non-qualified contracts to support their claims for violation of the Unfair Practices Act, fraud, and unjust enrichment, the district court did not err in denying Kinder Morgan's motion to compel arbitration. As the case proceeds, it may become clear that prices of non-qualified contracts or transportation charges are issues with respect to the Unfair Practices Act, fraud,

and/or unjust enrichment claims. If so, Plaintiffs must proceed with such claim or claims in arbitration. The district court is affirmed, with instruction to compel arbitration of Plaintiffs' claims for violation of the Unfair Practices Act, fraud, and unjust enrichment, rather than to allow any of these claims to go to trial, if the claims ultimately concern the prices of non-qualified contracts or transportation charges.

{27} **IT IS SO ORDERED.**

WE CONCUR: *A. JOSEPH ALARID* and *JONATHAN B. SUTIN*, Judges.

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs,

vs. **No. 04-26-CV**

KINDER-MORGAN CO2 COMPANY, L.P.

Defendant.

ORDER DENYING DEFENDANT'S MOTION TO COMPEL ARBITRATION AND FOR STAY PENDING ARBITRATION

(Filed Mar. 11, 2005)

THIS MATTER came before the Court on February 24, 2005 for hearing on Defendant Kinder-Morgan's Motion to Compel Arbitration and for Stay Pending Arbitration. The Court has considered the pleadings filed by the parties, has heard argument of counsel and has considered the evidence submitted on the Motion. The Court FINDS that the Motion is not well-taken and should be DENIED.

IT IS THEREFORE ORDERED that Kinder-Morgan's Motion to Compel Arbitration and for Stay Pending Arbitration is hereby DENIED.

/s/ Eugenio S. Mathis 3/8/05
Honorable Eugenio S. Mathis
District Court Judge

Submitted by:

GALLEGOS LAW FIRM, P.C.

By: /s/ JE Gallegos
J.E. Gallegos
Michael J. Condon
460 St. Michael's Drive, Bldg. 300
Santa Fe, New Mexico 87505

SUSMAN GODFREY, LLP

Thomas W. Paterson
NM Bar No. 16891
Shawn Raymond
1000 Louisiana, Suite 5100
Houston, Texas 77002-5096

Attorneys for Plaintiffs

APPROVED AS TO FORM:

VINSON & ELKINS LLP

By: Email Approved 03-04-05
Guy S. Lipe
2300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760

LONG, POUND & KOMER PA

John Pound
2200 Brothers Rd.
Santa Fe, NM 87501

Attorneys for Defendant Kinder Morgan

IN THE SUPREME COURT OF
THE STATE OF NEW MEXICO

October 11, 2006

NO. 29,990

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs-Respondents,

v.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant-Petitioner.

ORDER

WHEREAS, this matter came on for consideration by the Court upon petition for writ of certiorari filed pursuant to Rule 12-502 NMRA and response thereto, and the Court having considered said pleadings and being sufficiently advised, Chief Justice Richard C. Bosson, Justice Pamela B. Minzner, Justice Patricio M. Serna, Justice Petra Jimenez Maes, and Justice Edward L. Chavez concurring;

NOW, THEREFORE, IT IS ORDERED that the petition hereby is GRANTED and a writ of certiorari shall issue to the New Mexico Court of Appeals; and

IT IS FURTHER ORDERED that a subsequent order shall be entered identifying the issue(s) upon which the petition is granted and setting forth instructions regarding a briefing schedule, if any.

IT IS SO ORDERED.

WITNESS, Honorable Richard C. Bosson, Chief Justice of the Supreme Court of the State of New Mexico, and the seal of said Court this 11th day of October, 2006.

(SEAL) /s/ Kathleen Jo Gibson
Kathleen Jo Gibson, Chief Clerk
of the Supreme Court of the
State of New Mexico

IN THE SUPREME COURT OF
THE STATE OF NEW MEXICO

May 10, 2007

NO. 29,990

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs-Respondents,

v.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant-Petitioner.

ORDER

WHEREAS, this matter came on for consideration upon petition for writ of certiorari and response thereto filed pursuant to Rule 12-502 NMRA, and the Court having considered said pleadings and being sufficiently advised, issued its writ of certiorari on October 11, 2006; and

WHEREAS, having considered the petition, briefs, and oral argument by the parties, the judgment of the Court is that the writ shall be quashed as improvidently granted, Chief Justice Edward L. Chavez, Justice Pamela B. Minzner, Justice Patricio M. Serna, Justice Petra Jimenez Maes, and Justice Richard C. Bosson concurring;

NOW, THEREFORE, IT IS ORDERED that the writ of certiorari issued on October 11, 2006, hereby is QUASHED; and

IT IS FURTHER ORDERED that the record proper, supplemental record proper, and taped proceedings shall be returned to the New Mexico Court of Appeals.

IT IS SO ORDERED.

WITNESS, Honorable Edward L. Chavez, Chief Justice of the Supreme Court of the State of New Mexico, and the seal of said Court this 10th day of May, 2007.

(SEAL) /s/ Kathleen Jo Gibson
Kathleen Jo Gibson, Chief Clerk
of the Supreme Court of the
State of New Mexico

IN THE SUPREME COURT OF
THE STATE OF NEW MEXICO

MANDATE NO. 29,990

TO the New Mexico Court of Appeals, GREETINGS:

WHEREAS, in cause numbered 25,735 on your civil docket, wherein J. Casper Hiemann, et al., were plaintiffs, Kinder-Morgan CO2 Company, L.P., was defendant, an opinion was issued by the New Mexico Court of Appeals on August 8, 2006;

WHEREAS, the cause was afterwards brought by the State into this Court for review by petition for writ of certiorari, and a writ of certiorari was issued on October 11, 2006; and

WHEREAS, an order quashing the writ of certiorari was entered on May 10, 2007.

NOW, THEREFORE, this cause is remanded to you for further proceedings, if any.

WITNESS, Honorable Edward L. Chavez, Chief Justice of the Supreme Court of the State of New Mexico, and the seal of said Court this 10th day of May, 2007.

(SEAL) /s/ Kathleen Jo Gibson
Kathleen Jo Gibson, Chief Clerk
of the Supreme Court of the
State of New Mexico

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs,

vs. **No. 04-26-CV**

KINDER-MORGAN CO2 COMPANY, L.P.

Defendant.

CLASS ACTION COMPLAINT FOR DAMAGES AND INJUNCTION

(Filed Aug. 3, 2004)

Plaintiffs bring this action on behalf of themselves and royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit ("Unit") similarly situated and for their claims against the defendant Kinder-Morgan CO2 Company, L.P. ("Kinder-Morgan") state the following.

I.

PARTIES AND JURISDICTION

1. Plaintiff J. Casper Heimann is a resident of Union County. He is the owner of royalty interests in leases held by Kinder-Morgan in the Unit and was a representative plaintiff in the class action case styled *Doris Feerer, et al. v. Amoco Production Company, et al.*, U.S.D.C.N.M., Civ. No. 95-0012 JC/WWD ("Feerer Class Action"). Plaintiff

Pecos Slope Royalty Trust owns overriding royalty burdening leases in the Unit held by Kinder-Morgan; Robert P. Creson, Jr. and Cynthia C. Clendenen are trustees of the trust. Plaintiff Rio Petro Ltd., is a Texas limited partnership that owns overriding royalty burdening working interests in leases in the Unit held by Kinder-Morgan; Robert P. Creson, Jr. is the general partner.

2. Defendant Kinder-Morgan is a Texas limited partnership authorized to do business in New Mexico. Its resident agent for service of process is Corporation Service Company, Suite 223, 125 Lincoln Ave., Santa Fe, New Mexico 87501. Kinder-Morgan is the successor-in-interest and assignee from Shell Western E&P Inc. and Shell CO2 Company, Ltd. ("Shell") of extensive leasehold interests in the Unit and also to the obligations and responsibilities set forth in the Class Action Settlement Agreement in the Feerer Class Action. Kinder-Morgan is a major producer and transporter of carbon dioxide (CO2) and a major user of CO2 for tertiary oil recovery in the Permian Basin of Texas.

II.

VENUE

3. Venue is proper in this district pursuant to NMSA 1978 § 38-3-1A. and F. Plaintiff Heimann is a resident of Union County, New Mexico and defendant Kinder-Morgan is a foreign corporation admitted to do business in New Mexico.

III.

CLASS ACTION STATUS

4. This action arises from the failure of the defendant to pay the full royalty and overriding royalty ("Royalty Interests") on the true and proper settlement value of compressed CO2 produced from the Unit. Pursuant to Rule 1-023 NMRA 2004, the plaintiffs bring this action as a class action on their own behalf and on behalf of all current owners and former owners, during the period January 2000 to the present, who have Royalty interests burdening the oil and gas leases in the Unit held by the defendant. The class members are the private property Royalty Interest owners whose interests derive from fee lands, thus excluding the Commissioner of Public Lands and the United States of America. The class also excludes those private Royalty Interests that are not unitized as part of the Unit, the so-called unratified royalty owners.

5. The plaintiffs were members of a class certified as a class action by the Untied [sic] States District Court for the District of New Mexico in the Feerer Class Action.

6. On June 25, 1996, the United States District Court in the Feerer Class Action held that the class here proposed meets the requirements of Federal Rule of Civil Procedure 23 and should be certified under that class action procedure which applies the same standard for class actions as Rule 1-023 NMRA 2004. This action is functionally a continuation of the assertion of class-wide rights and claims for underpaid royalty and attendant causes of action that have arisen since the settlement of the Feerer Class Action on behalf of the same Royalty Interests owners class.

7. Each of the named plaintiffs own Royalty Interests in the Unit, and has done so and continues to do so for the period January 1, 2000 to the present. Each of the named plaintiffs has been and is paid on those Royalty Interests monthly by Kinder-Morgan, and Kinder-Morgan's method of calculation of such payment and the monthly remittance statement presentations by it are the same for all plaintiffs and all class members.

8. The oil and gas leases and other instruments creating the Royalty Interests were modified as to the basis for the payment of such interests by the terms of the Unit Agreement for the Development and Operation of the Unit (a copy of which is possessed by defendant). In turn the Class Action Settlement Agreement ("Settlement Agreement") entered on April 1, 1998 in the Feerer Class Action modified the Unit Agreement and established terms effective with Unit production on and after January 1, 1998 for the payment of royalty from the defendant to the plaintiffs and class members. A true copy of the Settlement Agreement is attached and incorporated as Exhibit "A".

9. The basis for the royalty settlement values to be used in paying the subject Royalty Interests is the same for all class members and, in summary terms, provides that sales or delivery of CO2 at the wellhead and reduction of values by netting out expenses of gathering, dehydration and compression are prohibited; that the "1994 Contract" (as defend [sic] in the Settlement Agreement) prices cannot be utilized; that value shall be formulated at the Unit Tailgate (as defined in the Settlement Agreement); that deductions for pipeline transportation on sales or delivery downstream from the Unit Tailgate are subject to specified cents per Mcf caps. Within the aforestated

terms, the Settlement Agreement provides the royalty values are to be "proper" and not "improper."

10. Each plaintiff and member of the class has been similarly underpaid Royalty Interests by Kinder-Morgan on CO2. The defendant has engaged in across the board methods of fabricating prices and fixing self serving false values for the Unit CO2 which practices financially impact each and every class members detrimentally in the same manner. Kinder-Morgan has failed to disclose these matters to plaintiffs and to the members of the class who previously had no knowledge of the underpayments and no information on which to assess the true and proper value of the CO2.

11. There is a well-defined commonality of interest in the questions of law and fact involved that affect the parties to be represented. Common questions of law and fact predominate over questions that may affect individual class members.

12. Plaintiffs are committed to prosecuting this action and have retained experienced and competent counsel with expertise in oil and gas industry litigation and the direct experience of prosecuting an action for damages for wrongful payment of State of New Mexico CO2 royalties on production from the Unit. The claims of plaintiffs are typical of the claims of the class, and plaintiffs have the same interests as other members of the class. Plaintiffs are adequate representatives of the class and will fairly and adequately protect the interests of all like situated Royalty Interest owners.

13. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Prosecution of separate actions by individual

members of the class would create a risk of inconsistent adjudication which would establish incompatible standards of conduct for the defendant, and adjudication with respect to individual members of the class would as a practical matter be dispositive of the interests of the other members not parties to the adjudication.

14. This action should be certified pursuant to Rule 1-23 NMRA 2004 as a class action that constitutes a continuation and updating of the class certified in the Feerer Class Action. The defendant as assignee of Shell and a party in privity therewith is estopped to oppose or deny the certification of the class and the suitability of plaintiffs as class representatives.

IV.

FACTS COMMON TO ALL CLAIMS

A. Background

15. CO2 is commonly volumetrically measured in an "Mcf," which is 1,000 cubic feet at a stated pressure basis, in this case at 14.73 psi or 15.025 psi. The word "gathering" as used here refers to the collecting of gas from each producing well and moving it by pipes to a central plant at Rosebud, New Mexico for compression and dehydration. A "pipeline is a high pressure transmission system which delivers the compressed and marketable CO2 from the Unit Tailgate to a terminus at Denver City, Texas, from where it may be transported in lateral" pipelines for tertiary recovery of oil. The word "price" when appearing in quotes herein is meant to indicate that defendant has attributed an amount of cents to an Mcf of CO2 at the Unit for its unilateral calculation of royalty, as contrasted with the common use of that word meaning an amount arrived

at in an arm's length transaction by economically opposed parties in a functioning market.

16. For more than twenty years major oil companies have used CO2 in their enhanced oil recovery ("EOR") operations in mature oil fields to recover oil not producible by primary or secondary means. In this regard, CO2 is injected into oil bearing reservoirs and enhances oil production by mixing with and displacing crude oil from the pore spaces in the oil bearing formations.

17. The Unit covers over 910,000 acres in Harding, Union and Quay Counties, New Mexico. It is the largest carbon dioxide gas unit in the United States and contains one of the largest known recoverable reserves of pure CO2 in the world. About 2.5 trillion cubic feet of gas has been produced from the Unit and it presently produces about 330-350 million cubic feet per day (MMCFD). Since April of 1984, the produced CO2 has been made marketable by gathering, dehydrating and compressing it into a super-critical state (at 1800-2000 psi) so that it is suitable to be transmitted by pipelines to the EOR fields in West Texas and Southeast New Mexico and there injected into the reservoirs for enhanced recovery of crude oil. In the case of mature oil fields that no longer produce on a primary basis and have undergone secondary recovery by waterflooding, the compressed CO2 is a crucial commodity that allows tertiary recovery of an additional 10-20% of the oil in such fields.

18. The proper economic value (as opposed to artificial "prices") of the Unit CO2 is directly related to the value of the oil that is recovered and sold by virtue of the CO2 injection.

19. Kinder-Morgan Energy Partners, the parent company, formed the defendant subsidiary in 2000 following its purchase of Shell CO2 Company, Ltd. The defendant is the assignee and successor in interest of Shell Western E & P Inc. and Shell CO2 Company Ltd. ("Shell") as to the latter companies' working interest and lessee obligations in the Unit and as to those Shell companies status as parties bound by the Settlement Agreement.

20. The Shell purchase by Kinder-Morgan included a 45% working interest in the McElmo Dome Field, a CO2 source field in southwestern Colorado, a 50% ownership in the Cortez pipeline, which transports CO2 to the Denver City pipeline hub and an 11% working interest in the Unit.

21. Shortly after the Shell acquisition Kinder-Morgan, or its parent company, purchased the SACROC Unit in Surrey County, Texas, a large EOR field that has been using CO2 for tertiary recovery for many years. Kinder-Morgan has expended hundred [sic] of millions of dollars in accelerating the CO2 development program for the SACROC Unit including drilling and reworking wells and constructing CO2 recycle and compression facilities. Kinder-Morgan is injecting 250-300 million cubic feet of CO2 each day at that field and has thereby increased daily the oil production of the SACROC Unit from 17,000 barrels to about 26,000 barrels.

22. In or about 2002, Kinder-Morgan increased its ownership in another West Texas EOR project, the Yates Field, to 50% in which CO2 flooding has been initiated and is being expanded.

23. The period January 2000 to the present has seen Kinder-Morgan's demand for and delivery of CO2 from the Unit and from McElmo Dome increase significantly and

correspondingly its production of oil has grown so that Kinder-Morgan is a leading Texas producer of oil based on CO2 flooding. Correspondingly, the period January 2000 to the present has seen historically unprecedented and sustained high oil prices. During that period the price per barrel of West Texas oil has been in the range of $25 to $40 per barrel with the higher end of that range occurring in 2003 and to the filing of this action in August 2004. Likewise, natural gas and natural gas liquids recovered with the EOR oil have sold at sustained high prices during the material period.

24. The consistently strong oil prices that began to be realized in late 1999 have greatly increased the demand for CO2 for enhanced oil recovery projects and the operators of the McElmo Dome and the Unit source fields have reacted by increased drilling of wells in an effort to provide a sufficient supply of CO2 to meet the growing demand.

25. There is no efficient market for the CO2 from the Unit. Over Ninety-five percent (95%) of the monthly Unit production is not bought or sold but rather is delivered-in-kind by Kinder-Morgan and other Unit working interest owners for their own use in EOR fields. Small quantities of the CO2 from the Unit are some times the subject of pretextual "bid" arrangements resulting in a sales contract reciting a "price" per Mcf of CO2 delivered at a Permian Basin oil field. Some Unit working interest owners have cited such "prices" as a basis for valuing CO2 produced at the Unit. From that "price" for CO2 at an oil field is deducted a unilaterally set transportation charge to arrive at the cents per Mcf on which a one-eighth (⅛) royalty or some single digit overriding royalty is calculated and paid.

B. Kinder-Morgan's Royalty Payments 2000-2004.

26. In the 2000-2004 period of historically high oil prices and historically high demand for Unit CO2, Kinder-Morgan has calculated and paid the Royalty Interests at the lowest CO2 prices relative to oil prices in the 20 year history of the Unit. Kinder-Morgan's simulated Unit Tailgate royalty settlement values have ranged between $0.42/Mcf to $0.59/Mcf, increasing by a few cents in the latter months of that period. The actual royalty cost per Mcf to Kinder-Morgan for its in-kind gas at the "prices" it simulates is 5-7 cents per Mcf on ⅛ royalty leases.

27. The oil and gas leases and other instruments creating the Royalty Interests were modified as to the basis for royalty payment by the Unit Agreement and the terms of the Unit Agreement in that regard have been superceded by the Settlement Agreement. Given the direct physical, functional and economic connection between the Unit CO2 and the recovery of and sale of oil and other hydrocarbons from the EOR fields where the CO2 is used, the growing demand for CO2 by EOR operators, and other relevant circumstances, the values set by the defendant for payment of the subject Royalty Interests are patently and significantly improper.

C. Damages and Concealment

28. By virtue of the vertical integration of the tertiary recovery activity of defendant consisting of (a) production of CO2, (b) transportation of the compressed CO2 and (c) injection of the CO2 for oil recovery, the defendant has been uniquely situated to know the true economics of this enterprise, to appreciate the highly crucial and essential role of the injectable CO2 and has

used that position to deliberately manipulate the financial consequence to be attributed to each of the three activities.

29. The defendant has intentionally and systematically acted to financially infringe upon and disregard the rights and interests of the plaintiffs and the class members who are the owners of the CO2 that has in the period in question provided much of the wealth Kinder-Morgan and its shareholders have enjoyed.

30. Kinder-Morgan has concealed the improper basis upon which the royalty calculations are made and the actual economic consequences and benefits enjoyed by it which economic benefits are not and have not been shared by Kinder-Morgan with the Royalty interest owners.

31. The plaintiffs and the class members are not sophisticated, knowledgeable or informed concerning the CO2 "price" formulating schemes of the defendant nor of the economics associated with the business of and tax benefits afforded EOR operations. The plaintiffs and the class members have only the information allowed them by defendant on the monthly remittance statements that set forth a price per Mcf, a supposed per well production volume and monetary amounts deducted for transportation and taxes.

IV.

FIRST CLAIM FOR RELIEF
Violation of Unfair Practices Act

32. Plaintiffs incorporate by reference the allegations of paragraphs 1 through 31.

33. The defendant has made false or misleading statements to the plaintiffs and the class by its monthly royalty remittances which tend to or have deceived and misled the plaintiffs concerning the value of Unit CO2 as it pertains to the payment amount of plaintiffs' Royalty Interests.

34. Defendant has taken advantage of the lack of knowledge of the plaintiffs to a grossly unfair degree and paid the Royalty Interests in an amount grossly less than the proper and real value.

35. The defendant has engaged in unfair and deceptive trade practice and unconscionable trade practices, and it has done so knowingly and willfully in violation of the Unfair Practices Act, NMSA 1978 Section 57-12-1 et seq. (1995) entitling the plaintiffs to an award of compensatory damages in the amount of three times actual damages, and for an award of attorneys' fees and costs.

SECOND CLAIM FOR RELIEF
Constructive Fraud

36. Plaintiff incorporates by reference the allegations of paragraphs 1 through 35.

37. By virtue of the relationship between plaintiffs and class members and on the other hand the defendant as a working interest owner on whom the class members depend for development of the minerals, and owing to the trust and reliance on the honesty of defendant that the plaintiffs and the class must necessarily place in the defendant and other Unit working interest owners, and because of the superior and important knowledge concerning the CO2 economics and uses available only to it,

defendant at all times owed to plaintiffs a duty to fully and fairly disclose to the plaintiffs and to the class members the true and complete material information concerning the proper value of the Unit produced CO2 upon which the Royalty Interest payments should be made.

38. By having made monthly reports to the plaintiffs and class members purportedly providing information as to the basis for payment of the Royalty Interests, the defendant had and has a duty to disclose completely and truthfully all material facts that pertain to the true and proper value of the CO2 and the correct Royalty Interests calculation. The value reducing scheme exerted by defendant is contrary to public policy and to sound and accepted morals.

39. The defendant has breached the described duties to the plaintiffs and those breaches constitute constructive fraud which has proximately caused damages to the plaintiffs. The defendant's breaches were and are intentional, willful, malicious and undertaken with a culpable state of mind so that punitive damages should be awarded to plaintiffs as determined at trial.

THIRD CLAIM FOR RELIEF
Breach of Contract and of the Covenant of Good Faith and Fair Dealing

40. Plaintiffs incorporate by reference the foregoing paragraphs 1 through 35.

41. The Settlement Agreement provides that effective for Unit CO2 production occurring on and after January 1, 1998, the Royalty Interests of the plaintiffs and

class members would be calculated in accordance with that agreement by defendant as successor to Shell.

42. As applicable to calculation and payment of the subject Royalty Interests by defendant for the period beginning January 2000 the point of valuation is the Unit Tailgate, Unit area expense cannot be deducted to reduce or net-back the price and the pipeline charge is capped. The CO2 royalty settlement value to be used by defendant in paying the subject Royalty interests must be "proper."

43. Kinder-Morgan has for the material time uniformally set "prices" that are not formed by true market forces, are grossly less than the value relative to the oil and other hydrocarbons that but for the CO2 would not be recovered and are fixed by the defendant to serve its objectives of (a) reducing expense and (b) maximizing its profit. That conduct has breached and continues to breach the letter and intent of the Settlement Agreement.

44. Every contract in New Mexico imposes the duty of good faith and fair dealing upon the parties in performance and enforcement of the contract, and particularly such duty is imposed upon contracts for the purchase and sale of a commodity. NMSA 1978 § 55-1-203.

45. Kinder-Morgan has breached its contractual obligations and acted in bad faith by fabricating improper and dishonest "prices" for Unit CO2.

46. The foregoing acts and breaches of duties were done intentionally to cause damage and as a part of and in furtherance of a scheme by defendant the object of which is to wrongfully deprive the plaintiffs and the class of their lawful rights and interests, including the right to receive proper royalties for CO2 produced from the Unit.

47. Defendant's breach of the Settlement Agreement and of the implied covenant was done and is continued intentionally, with a wanton disregard of plaintiffs' rights, maliciously and with a culpable state of mind, so that plaintiffs and the class should be awarded punitive damages in such amount as determined at trial.

FOURTH CLAIM FOR RELIEF
Breach of Implied Covenant to Market

48. Plaintiffs incorporate by reference the allegations of paragraphs 1 through 47.

49. As a working interest owner, defendant is subject to an implied covenant to market which extends to plaintiffs and all class members. At all times defendant was and is obligated, among other things, to act with due regard for the rights and interests of the class members and to achieve the best price or value for CO2 produced from the Unit reasonably possible under the circumstances.

50. Defendant either took CO2 in kind from the Unit for its own use or sold it to itself at self-fixed "prices" whose true function was and is to reduce the business costs of royalty, overriding royalty and State of New Mexico severance taxes. In doing so, defendant deliberately breached its implied duties to market the CO2, and deliberately failed to achieve or to derive the best prices reasonably available for the sale or delivery of such CO2 or to pay the Royalty Interests, on the basis of the true and proper relative value in the use of such CO2 for tertiary oil recovery.

51. Defendant's acts in breach of the implied duty to market were done intentionally to cause damage and as a part of and in furtherance of a conspiracy between and among unit working interest owners, the object of which is to wrongfully deprive plaintiffs and class of their lawful rights and interest, including the right to receive just and proper royalties for CO2 produced from the Unit. As a result of its breach of the implied covenant to market, defendant has proximately caused the plaintiffs and class members to suffer actual damages.

52. Defendant's breach of the implied covenant was done and is continued, intentionally, maliciously and with a culpable state of mind, so that plaintiffs and the class should be awarded punitive damages in such amount as determined at trial.

FIFTH CLAIM FOR RELIEF
Accounting, Unjust Enrichment and Injunction

53. Plaintiffs incorporate by reference the allegations of paragraphs 1 through 31.

54. By virtue of its position as lessee, by virtue of covenants implied at law and by virtue of principles of equity, the defendant as mineral lessee exploiting the economic fruits of Unit CO2 has a duty to share those economic benefits with plaintiffs and class members in proportion to those owners' respective fractional divisions of Royalty Interests in the CO2 produced from the Unit leases.

55. The defendant has willfully and in violation of duties imposed by law and equity failed and continues to fail to fairly share the true economic benefit of the CO2

produced from the Unit subject to plaintiffs' Royalty Interests by devices and payment methods which have and do deprive plaintiffs and the class members of their proper Royalty Interests entitlement.

56. It is necessary and fitting that defendants account for, disgorge and pay to plaintiffs and the class members all Royalty Interests amounts it is determined by the Court that defendant has failed to pay in the past as required by law and equity and do so in order that defendant shall no longer be unjustly enriched.

57. Due to the nature of the relationship between defendant and plaintiffs and the class members, that relationship will continue into the future after entry of judgment in this case; defendant will remain obligated to pay future Royalty Interest payments to plaintiffs and members of the class. Plaintiffs are entitled to an Order permanently enjoining defendants from utilizing its current, improper methods of royalty calculation and payment, in whole or in part, to the extent that such methods are determined to be wrongful and mandating true and proper calculation and payment of Royalty Interests in a manner established by the evidence.

58. With respect to the request for injunctive relief as to prospective Royalty Interest payments, plaintiffs lack an adequate remedy at law. Without an award of injunctive relief, plaintiffs will be required to file a multiplicity of suits in order to enforce their rights.

WHEREFORE the plaintiffs pray the orders and judgment of the Court,

A. That at the earliest practicable time the Court certify this case as a class action and the plaintiffs as a class representatives of a class defined as follows:

> All present and former owners of royalty interests or overriding royalty interests in fee lands whose interests have been unitized under the Bravo Dome Carbon Dioxide Unit Agreement and whose interests burden leases held by the defendant Kinder-Morgan and have since January 2000.

B. That upon trial the Court award the plaintiffs and the class compensatory damages, punitive damages, pre-judgment interest, attorney fees and costs.

C. That the Court enter its injunction against the defendant's continued unlawful and wrongful conduct and affirmatively require and specify a method of Royalty Interests calculation that reflects the proper and true value of the Unit CO2 as an agent for the recovery of otherwise unrecoverable oil.

D. That the Court grant such other and further relief as is proper.

Respectfully submitted,

GALLEGOS LAW FIRM, P.C.

By /s/ J E Gallegos
J.E. GALLEGOS
MICHAEL J. CONDON
460 St. Michael's Drive, Bldg. 300
Santa Fe, New Mexico 87505
(505) 983-6686

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs,

vs. No. D-818-CV-2004-00026

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant

DEFENDANT KINDER MORGAN CO2 COMPANY, L.P.'S MOTION TO COMPEL ARBITRATION AND FOR STAY PENDING ARBITRATION

(Filed Oct. 1, 2004)

COMES NOW, Kinder Morgan CO2 Company, L.P. ("Kinder Morgan"), and submits this Motion to Compel Arbitration and for Stay Pending Arbitration.

I.

INTRODUCTION

Plaintiffs J. Casper Heimann, Pecos Slope Royalty Trust, and Rio Petro Ltd. ("Plaintiffs") assert claims relating to alleged underpayment of royalties on carbon dioxide produced from the Bravo Dome Carbon Dioxide Unit ("the Unit"). As demonstrated herein, all of Plaintiffs' claims are subject to mandatory arbitration pursuant to an arbitration clause contained in a settlement agreement

executed in connection with the settlement of prior royalty litigation involving the Unit. Plaintiffs clearly and unequivocally acknowledged the arbitrability of the claims by filing an arbitration demand seeking arbitration of the claims pursuant to the arbitration clause in the settlement agreement, but Plaintiffs subsequently withdrew that arbitration demand and filed this lawsuit. Both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act require that Plaintiffs be compelled to arbitrate their claims and that this action be stayed pending arbitration.

A. The Parties

Plaintiffs claim to be royalty owners in the Bravo Dome Carbon Dioxide Unit ("the Unit"). Since January 2000, Kinder Morgan has owned working interests in the Unit and has produced and sold carbon dioxide from the Unit and paid royalties thereon. Kinder Morgan acquired its interest in the Unit from Shell Western E&P Inc. and Shell CO2 Company Ltd. (collectively "Shell"). Plaintiffs purport to assert claims against Kinder Morgan on behalf of themselves and on behalf of a class of former and current royalty owners during the period January 2000 to present who own or owned royalty interests burdening the oil and gas leases in the Unit held by Kinder Morgan.

B. The *Feerer* Settlement

Prior to Kinder Morgan's acquisition of an interest in the Unit, a settlement agreement was entered into in connection with a class action lawsuit pending in the United States District Court for the District of New Mexico, styled *Feerer, et. al. v. Amoco Prod. Co., et. al.*, Civ.

No. 95-0012 JC/WWD. In the *Feerer* case, the plaintiffs asserted, among other things, that the owners of working interests in the Unit, including Shell (Kinder Morgan's predecessor-in-interest), had underpaid royalties. Plaintiff J. Casper Heimann, who is one of the named plaintiffs in this case, was a named plaintiff and a class representative in the *Feerer* case and was a signatory party to the settlement agreement. The settlement agreement was entered into on behalf of the named plaintiffs and on behalf of a settlement class of private royalty owners in the Unit. A true and correct copy of the settlement agreement in the *Feerer* case is attached hereto as Exhibit 1 and is referred to herein as "the Settlement Agreement."

C. The Agreed Royalty Methodology Provided in the Settlement Agreement

As part of the settlement, the settlement class of royalty owners and the working interest owners in the Unit agreed to a methodology for the calculation of royalties subsequent to January 1, 1998. Specifically, Section 14 of the Settlement Agreement provides that the working interest owners "will utilize the royalty settlement methodology and the identified benchmarks set forth in subparagraphs (a), (b) and (c) below for the purpose of calculating and paying royalty to their Respective Owners, which methodology, benchmarks and resulting payments are hereby agreed to and approved by Amoco's, Hess's and Shell's Respective Owners." That methodology involves the use of a "net-back" price in calculating royalties.

Specifically, the royalty owners agreed that the working interest owners could use certain specified pre-approved

sales contracts and certain specified pre-approved transportation charges in calculating the net-back price used to pay royalty. With regard to Shell, the pre-approved sales contracts (referred to in the Settlement Agreement as "Qualified Contracts") were identified in Schedule D-3 of the Settlement Agreement, and the pre-approved transportation charges (referred to in the Settlement Agreement as the "Approved Mainline Deduction" and the "Qualified Other Transportation Charges") were identified in Section 11.2(a) and Schedule E-3 of the Settlement Agreement. The Settlement Agreement provided in Section 14(c) that the working interest owners were not precluded from using benchmarks other than the "Qualified" sales contracts and the "Approved" and "Qualified" transportation charges, but there was no pre-approval of such other contracts by the royalty owners. Any contract prices and transportation charges used by the working interest owners in the calculation of royalties that were not approved by the royalty owners in the Settlement Agreement were defined in Sections 14(g) and 14(h) of the Settlement Agreement as "Non-Qualified Contracts" and "Non-Qualified Other Transportation Charges," respectively. In Section 14(j) of the Settlement Agreement, the royalty owners expressly reserved the right to claim in the future that a Non-Qualified Contract or a Non-Qualified Other Transportation Charge used in the calculation of royalties was improper.

As noted above, Plaintiff J. Casper Heimann was a named plaintiff in the *Feerer* case and was a signatory party to the Settlement Agreement. Plaintiffs Pecos Slope Royalty Trust and Rio Petro Ltd. are current royalty payees of Kinder Morgan and allege in this lawsuit that they are entitled to enforce the Settlement Agreement.

D. The Arbitration Clause

Section 16 of the Settlement Agreement contains a mandatory arbitration provision. Specifically, the royalty owners and the working interest owners agreed as follows:

> Any claims asserted by Plaintiffs or members of the Class against Amoco, Hess or Shell regarding (a) the price or value under Non-Qualified Contracts (or under amendments to or extensions of contracts establishing new prices or values under Qualified contracts as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners and, (b) regarding Non-Qualified Other Transportation. Charges (or amendments to or extensions of contracts or other arrangements establishing Qualified Other Transportation Charges as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding arbitration. . . .

E. Kinder Morgan's Royalty Payments Utilizing the Settlement Agreement Methodology

Since Kinder Morgan acquired its interest in the Unit, it has calculated and paid royalty using the net-back methodology provided in the Settlement Agreement. That methodology has involved determination of net-back prices, using both Qualified Contracts and Non-Qualified Contracts, Approved Mainline Deductions, and Non-Qualified Other Transportation Charges, as those terms are defined in the Settlement Agreement. Attached hereto

as Exhibits 2, 3, 4, 5, and 6 are true and correct copies of the royalty price calculation spreadsheets reflecting the manner in which Kinder Morgan calculated the net-back prices used in paying royalties to its private royalty owners for the period January 2000 through July 2004. Attached hereto as Exhibit 7 is a spreadsheet summarizing the sales contracts that Kinder Morgan has utilized in the calculation of the net-back prices used in the payment of royalties at various times over that same period. Attached hereto as Exhibit 8 is a sample of remittance statements for royalty payments made to Plaintiffs that utilize the net-back prices calculated pursuant to the Settlement Agreement.

F. The Plaintiffs' Arbitration Demand and Subsequent Lawsuit

On July 26, 2004, Plaintiffs filed a "Statement of Class Action Claims and Notice of Demand for Arbitration," referred to herein as "Plaintiffs' Arbitration Demand." A true and correct copy of Plaintiffs' Arbitration Demand is attached hereto as Exhibit 9. Pursuant to the arbitration clause in Section 16 of the Settlement Agreement, Plaintiffs submitted these claims to arbitration on their own behalf, and on behalf of a class of current and former royalty owners in the Unit. However, a week later, on August 2, 2004, Plaintiffs filed a "Withdrawal" of Plaintiffs' Arbitration Demand. A true and correct copy of the "Withdrawal" is attached hereto as Exhibit 10. The next day, on August 3, 2004, Plaintiffs filed this lawsuit.

II.

SUMMARY OF ARGUMENT

The Settlement Agreement provides the agreed-upon net-back methodology for calculation and payment of royalties. That agreement establishes a safe harbor for royalty payments to the extent that the net-back calculation is based on Qualified Contracts, Approved Mainline Deductions, and Qualified Other Transportation Charges. Royalty owners are entitled, however, to challenge the net-back calculation (and resulting valuations and payments) to the extent based on Non-Qualified Contracts and Non-Qualified Other Transportation Charges. The law requires that the Court look to the factual allegations of the complaint to determine whether the claims sought to be asserted in this lawsuit fall within the scope of the arbitration clause. All of Plaintiffs' claims are necessarily predicated on a challenge to the portions of Kinder Morgan's net-back price calculations that are subject to challenge under the Settlement Agreement, i.e., the portions of the calculations that utilize "Non-Qualified" contracts and "Non-Qualified" transportation charges. Section 16 of the Settlement Agreement provides that such claims are subject to mandatory arbitration. The agreement to arbitrate is enforceable under both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act, and accordingly, both federal and New Mexico law require that arbitration of the claims be compelled, and that this action be stayed pending arbitration.

III.

ARGUMENT AND AUTHORITIES

A. Both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act Require Enforcement of the Arbitration Clause

Section 2 of the Federal Arbitration Act ("FAA") provides that arbitration agreements "involving commerce" are enforceable in both state and federal courts as a matter of federal substantive law. 9 U.S.C. §2; *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984). The "involving commerce" standard is a broad one, reaching any transaction that is within the scope of Congress' power to regulate under the Commerce Clause of the Constitution. *Citizen's Bank v. Alafabco Inc.*, 539 U.S. 52, 56 (2003) ("We have interpreted the term 'involving commerce' in the FAA as the functional equivalent of the more familiar term 'affecting commerce' – words of art that ordinarily signal the broadest permissible exercise of Congress' Commerce Clause power"). The agreements between the private royalty owners and the working interest owners in the Unit, including the net-back price royalty methodology provided for in the Settlement Agreement, relate to the production, transportation, and sale of carbon dioxide in interstate commerce. Thus, the Federal Arbitration Act applies and requires enforcement of the arbitration clause contained in Section 16 of the Settlement Agreement. Furthermore, the arbitration agreement is enforceable as a matter of New Mexico law, pursuant to the New Mexico

Uniform Arbitration Act, NMSA 1978, §§ 44-7-1 to -22 (repealed 2001).[1]

Under both federal and New Mexico law, a court is required to compel arbitration upon a determination that a dispute falls within the scope of an arbitration clause. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219 (1985) ("a court must compel arbitration of otherwise arbitrable claims, when a motion to compel arbitration is made"); *American Express Fin. Advisors v. Makarewicz,* 122 F.3d 936, 940 (11th Cir. 1997) ("[u]nder the FAA, upon motion of a party, district courts must compel arbitration of all claims subject to arbitration"); *Santa Fe Techs. v. Argus Networks,* 131 N.M. 772, 788, 42 P.3d 1221, 1237 (N.M. App. 2001) ("when parties have agreed to arbitrate, the courts must compel arbitration"). Pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. §3, both federal and state courts are required to stay proceedings with regard to claims that are subject to arbitration. *Shearson/ American Express v. McMahon,* 482 U.S. 220, 226 (1987) ("a court must stay its proceedings if it is satisfied that an issue before it is arbitrable under the agreement," citing 9 U.S.C. §3); *United Nuclear Corp v. General Atomic Co.*, 597 P.2d 290, 308 (N.M. 1979) ("Section 3 of the Federal Arbitration Act provides for a stay of pending court action on application of one of the parties when the trial court is satisfied that the issue involved is referable to arbitration and that the applicant for the stay of court proceedings is not in default in proceeding with such arbitration").

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[1] Effective July 1, 2001, the version of the Uniform Arbitration Act in effect at the time the Settlement Agreement was executed was replaced by a new Uniform Arbitration Act, NMSA 1978, §§ 44-7A-1 to -32 (2001).

B. Plaintiffs' Claims Fall Within the Scope of the Arbitration Clause in Section 16

With regard to the question of whether a particular claim is subject to arbitration, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *DeArmond v. Haliburton Energy Servs.*, 81 P.2d 573, 577 (N.M. App. 2003). As the Third Circuit said in *In re Prudential Ins. Co. of Am. Sales Practice Litigation*, 133 F.3d 225, 231 (3rd Cir. 1998):

> Any inquiry into the scope of an arbitration clause must necessarily begin with the presumption that arbitration applies. In considering the nature of the dispute and the scope of the arbitration clause, this court must operate under a "presumption of arbitrability in the sense that 'an order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.'" Thus, when it cannot be said "with positive assurance" that the parties have clearly and unequivocally excepted a certain dispute from arbitration, the court must compel arbitration. A necessary corollary of this axiomatic rule in favor of arbitration is that doubts in interpreting the precise scope of the arbitration agreement are to be resolved in favor of arbitration. While this approach is not a mandate for courts to ignore explicit textual agreements or to reshape the parties' obvious intent, it nevertheless weighs genuine ambiguities against the resisting party.

(citations omitted). Furthermore, in answering the question of whether claims asserted in a case fall within the

scope of an arbitration agreement, the court is to "focus on the factual allegations in the complaint rather than the legal causes of action asserted." *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d 861, 871 (10th Cir. 1999).

Applying these principles, all of Plaintiffs' claims are subject to arbitration. The royalty owners subject to the Settlement Agreement agreed in Section 16 to arbitrate claims "regarding ... the price or value under Non-Qualified Contracts" and claims "regarding Non-Qualified Other Transportation Charges" that were utilized by the working interest owners "in establishing royalty settlement values for purposes of payment to their Respective Owners." As shown below, each of Plaintiffs' causes of action constitutes an attack on the use of "Non-Qualified" contracts and "Non-Qualified" transportation charges utilized in the calculation of net-back prices on which Kinder-Morgan based its royalty payments.

All of Plaintiffs' claims are predicated on the allegation that Kinder Morgan's royalty payments on Unit carbon dioxide since January 1, 2000 are based on net-back valuations that yield values that are too low. The Settlement Agreement provides for a net-back price methodology that utilizes a combination of "Qualified" and "Non-Qualified" contract prices and "Qualified," "Approved," and "Non-Qualified" transportation charges, with the portic of the calculations that are based on "Qualified" contracts and on "Qualified" and "Approved" transportation charges being pre-approved by the royalty owners. As shown by Exhibits 2 through 8 and the Affidavits of Dr. Stephen Becker and James Wuerth attached hereto as Exhibits 11 and 12, Kinder Morgan has paid its royalty based on net-back prices calculated using a combination of "Qualified" and "Non-Qualified" contract prices

and a combination of "Qualified," "Approved," and "Non-Qualified" transportation charges. Because the "Qualified" and "Approved" components of the calculations are not subject to challenge under the Settlement Agreement, Plaintiffs' claims that royalty was paid on a value that was too low are necessarily predicated on the allegation that the "Non-Qualified" components in the royalty calculations yield values that are too low. Accordingly, all of Plaintiffs' claims are subject to arbitration under Section 16 of the Settlement Agreement.

A review of the specific allegations of the Complaint confirms that Plaintiffs' claims fall within the scope of the arbitration clause. In paragraph 4 of the Complaint, Plaintiffs allege that "[t]his action arises from the failure of the defendant to pay the full royalty and overriding royalty . . . on the true and proper settlement value of compressed CO2 produced from the Unit." That this attack is predicated on the alleged wrongful use of prices from "Non-Qualified" contracts and of "Non-Qualified" transportation charges is confirmed by the following allegations:

- "[Kinder Morgan] has engaged in across the board methods of fabricating prices and fixing self serving false values for the Unit CO2." Complaint at ¶10.
- "The word 'price' when appearing in quotes herein is meant to indicate that defendant has attributed an amount of cents to an Mcf of CO2 at the Unit for its unilateral calculation of royalty." Complaint at ¶15.
- "The proper economic value (as opposed to artificial 'prices') of the Unit CO2 is directly related to the value of the oil that is recovered and sold by virtue of the CO2 injection." Complaint at ¶18.

- "Small quantifies of the CO2 from the Unit are some times the subject of pretextual "bid" arrangements resulting in a sales contract reciting a 'price' per Mcf of CO2 delivered at a Permian Basin oil field. Some Unit working interest owners have cited such 'prices' as a basis for valuing CO2 produced at the Unit. From that 'price' for CO2 at an oil field is deducted a unilaterally set transportation charge to arrive at the cents per Mcf on which a one-eighth royalty or some single digit overriding royalty is calculated and paid." Complaint at ¶25.

- "The oil and gas leases and other instruments creating the Royalty Interests were modified as to the basis for royalty payment by the Unit Agreement and the terms of the Unit Agreement in that regard have been superceded by the Settlement Agreement. Given the direct physical, functional and economic connection between the Unit CO2 and the recovery of and sale of oil and other hydrocarbons from the EOR fields where the CO2 is used, the growing demand for CO2 by EOR operators, and other relevant circumstances, the values set by the defendant for payment of the subject Royalty Interests are patently and significantly improper." Complaint at ¶27.

These allegations, which are applicable to all causes of action, demonstrate that Plaintiffs are challenging the "prices" used by Kinder Morgan in calculating CO2 values for royalty payment purposes, which Plaintiffs characterize as "fabricat[ed]," "pretextual," and "artificial," as well as transportation charges that Kinder Morgan has used in calculating CO2 values for royalty payment purposes, which Plaintiffs characterize as "unilaterally set." Because the "Qualified" contract prices and "Qualified" and "Approved"

transportation charges utilized in Kinder Morgan's calculation of the net-back prices used in its royalty payments are not subject to challenge under the Settlement Agreement, the challenged prices and transportation charges are of necessity "Non-Qualified" prices and charges. Plaintiffs' challenges fall directly within the scope of the arbitration clause.

It is "the factual allegations in the complaint rather than the legal. causes of action asserted" that are significant in determining whether claims fall within the scope of an arbitration clause. *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d at 871. The allegations described above, which are incorporated by reference in each of the causes of action asserted in the Complaint, demonstrate that all of Plaintiffs' claims fall within the scope of the arbitration clause. Although there is no need for detailed analysis of the legal causes of action that Plaintiffs assert in this case, such an analysis confirms that all causes of action asserted by the Plaintiffs are arbitrable.

1. Violation of Unfair Practices Act

Plaintiffs assert a violation of the New Mexico Unfair Practices Act, NMSA 1978 Section 57-12-1 et. seq. (1985). That claim incorporates by reference all of the allegations described above, and is based on the alleged payment of the royalty interests "in an amount grossly less than the proper and real value," and on alleged false and misleading statements "concerning the value of Unit CO2 as it pertains to the payment amount of plaintiffs' Royalty Interests." Complaint at ¶¶32-35. The basis for this claim is Plaintiffs' allegation that Kinder Morgan paid royalty on a calculated CO2 value that allegedly is too low. As demonstrated above,

the underpayment allegation necessarily is based on binder Morgan's use of "Non-Qualified" prices and charges that Plaintiffs challenge. Thus, the claim falls within the scope of Section 16 of the Settlement Agreement and is arbitrable, To the extent the Unfair Practices Act provides a judicial forum for claims under that statute, the Federal Arbitration Act preempts any such provision and mandates an order compelling arbitration and staying the proceedings. *See Southland Corp. v. Keating,* 465 U.S. at 10-16 (provision of California franchise statute providing judicial forum for claims was preempted by the FAA); *Commerce Park at DFW Freeport v. Mardian Construction Co.,* 729 F.2d 334, 339-40 (5th Cir. 1984) (provision of Texas Deceptive Trade Practices Act precluding waiver of judicial forum was preempted by the FAA).

2. Constructive Fraud

This claim incorporates the allegations referenced above and is based on Kinder Morgan's alleged "value reducing scheme" and on Kinder Morgan's alleged failure to disclose facts pertaining to "the true and proper value of the CO2 and the correct Royalty Interests calculation." Complaint at ¶38. As shown above, Plaintiffs' challenge to Kinder Morgan's royalty valuation of the CO2 is necessarily based on Kinder Morgan's use of "Non-Qualified" prices and charges. This claim also falls within the scope of Section 16 of the Settlement Agreement and is arbitrable.

3. Breach of Contract and of the Covenant of Good Faith and Fair Dealing

In this claim Plaintiffs incorporate by reference the allegations of paragraphs 1-35 of the Complaint, and they

allege that Kinder Morgan has breached its contractual obligations as follows:

> Kinder Morgan has for the material time uniformly set "prices" that are not formed by true market forces, are grossly less than the value relative to the oil and other hydrocarbons that but for the CO2 would not be recovered and are fixed by the defendant to serve its objectives of (a) reducing expense and (b) maximizing its profit. That conduct has breached and continues to breach the letter and intent of the Settlement Agreement.

Complaint at ¶43. Plaintiffs also allege that "Kinder Morgan has breached its contractual obligations and acted in bad faith by fabricating improper and dishonest 'prices' for Unit CO2." Complaint at ¶45. Again, the "prices" that Plaintiffs challenge in this claim are necessarily the "Non-Qualified" prices that Kinder Morgan uses in its royalty calculations. Thus, the claim is squarely within the scope of Section 16 of the Settlement Agreement.

4. Breach of Implied Covenant to Market

This claim incorporates all prior allegations and asserts that Kinder Morgan breached an implied covenant to market by virtue of the following alleged conduct:

> [Kinder Morgan] either took CO2 in kind from the Unit for its own use or sold it to itself at self-fixed "prices" whose true function was and is to reduce the business costs of royalty, overriding royalty and State of New Mexico severance taxes. In doing so, [Kinder Morgan] deliberately breached its implied duties to market the CO2, and deliberately failed to achieve or to derive the

> best prices reasonably available for the sale or delivery of such CO2 or to pay the Royalty Interest, on the basis of the true and proper relative value in the use of such CO2 for tertiary oil recovery.

Complaint at ¶50. This claim expressly challenges the "prices" that Kinder Morgan used in the calculation and payment of royalties to the royalty owners. Because the prices in "Qualified" contracts are not subject to challenge under the Settlement Agreement, this claim necessarily constitutes a challenge to "Non-Qualified" prices and is arbitrable under Section 16 of the Settlement Agreement.

5. Accounting, Unjust Enrichment and Injunction

This claim incorporates paragraphs 1-31 of the Complaint and asserts that Kinder Morgan should be required to account for and disgorge amounts that it has failed to pay as proper royalties by virtue of its "devices and payment methods which have and do deprive plaintiffs and the class members of their proper Royalty Interests entitlement." Complaint at ¶55. Again, this attack on Kinder Morgan's "payment methods" necessarily represents a challenge to the use of "Non-Qualified" prices and charges in the net-back calculation methodology provided for in the Settlement Agreement. Plaintiffs also seek an order "permanently enjoining [Kinder Morgan] from utilizing its current, improper methods of royalty calculation and payment, in whole or in part, to the extent that such methods are determined to be wrongful. . . ." This request for injunctive relief directly attacks the portions. of Kinder Morgan's net-back price calculation methodology that was not pre-approved in the Settlement Agreement, i.e., the portions of the calculations utilizing "Non-Qualified"

prices and charges. The request for injunctive relief is arbitrable.

C. Plaintiffs' Class Action Allegations Do Not Affect Kinder Morgan's Right to an Order Compelling Arbitration and Staying the Litigation

Plaintiffs purport to assert their claims both on their own behalf and on behalf of a class of royalty owners in the Unit. However, Plaintiffs – who have agreed to arbitrate – cannot avoid their obligation to arbitrate by filing a class action lawsuit. *In re Managed Care Litigation,* 132 F.Supp.2d 989, 999-1000 (S.D. Fla. 2000), *aff'd,* 285 F.3d 971 (11th Cir. 2002). As the Seventh Circuit said in *Caudle v. American Arbitration Association,* 230 F.3d 920, 921 (7th Cir. 2000), "A procedural device aggregating multiple persons' claims in litigation does not entitle anyone to be in litigation; a contract promising to arbitrate the dispute removes the person from those eligible to represent a class of litigants" in a class action court action. *See also Johnson v. West Suburban Bank,* 225 F.3d 366, 368 (3rd Cir.2000) (holding that the district court erred in denying the defendant's motion to compel arbitration and for stay pending arbitration of plaintiffs' claims, despite the existence of class action allegations). Because Plaintiffs are bound to arbitrate their claims under Section 16 of the Settlement Agreement, this Court should compel arbitration and stay this case pending arbitration. The question of whether arbitration is appropriate with regard to the claims made on behalf of the persons Plaintiffs seek to represent as a "class" is a question that must be determined by the arbitrators. *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444, 450-453 (2003); *Pedcor Management*

Co., Inc. Welfare Benefit Plan v. Nations Personnel of Texas, Inc., 343 F.3d 355, 358-361 (5th Cir. 2003).

IV.

CONCLUSION AND PRAYER

For the reasons discussed above, all of the Plaintiffs' claims fall within the scope of the arbitration clause contained in Section 16 of the. Settlement Agreement. In filing Plaintiffs' Arbitration Demand, Plaintiffs expressly invoked Section 16 of the Settlement Agreement and submitted the claims to arbitration, clearly and unequivocally acknowledging the arbitrability of the claims that they now seek to pursue in court. Plaintiffs' action in withdrawing the Arbitration Demand and filing this lawsuit is contrary to the requirements of Section 16. Even if there were doubts about the arbitrability of the claims, those doubts would be properly resolved in favor of arbitration. *Moses H. Cone,* 460 U.S. at 24-25; *DeArmond,* 81 P.2d at 577; *In re Prudential Ins. Co. of Am. Sales Practice Litigation,* 133 F.3d at 231. The FAA and the New Mexico Uniform Arbitration Act mandate that Plaintiffs be compelled to arbitrate, and that this case be stayed pending arbitration. The determination of whether arbitration is appropriate with regard to the claims asserted on behalf of the "class" that Plaintiffs seek to represent must be resolved by the arbitrators.

Accordingly, Kinder Morgan respectfully prays that the Court enter an order compelling Plaintiffs. to arbitrate their claims, staying the proceedings in this ease pending arbitration, and directing that the question of whether arbitration is appropriate with regard to the claims asserted on behalf of the proposed class members is to be

determined by the arbitrators. Kinder Morgan also seeks such other and further relief to which it is justly entitled.

LONG, POUND & KOMER, P.A.
Attorneys for Defendant

/s/ John B. Pound

JOHN B. POUND
2200 Brothers Road
P. O. Box 5098
Santa Fe, NM 87502-5098
505-982-8405
505-982-8513 (FAX)

VINSON & ELKINS L.L.P.

Guy S. Lipe
Texas State Bar No. 12394600
Andrew McCollam, III
Texas State Bar No. 13431812
Richard H. Page
Texas State Bar No. 15410100
2300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
(713) 758-1109
(713) 615-5607 Fax

CERTIFICATE OF SERVICE

I hereby certify that on this 28 day of September, 2004, a true and correct copy of the foregoing Motion to Compel Arbitration and for Stay Pending Arbitration was mailed first class, postage prepaid, to the following counsel of record:

J. E. Gallegos, Esq.
Michael J. Condon, Esq.
Gallegos Law Firm, P.C.
460 St. Michael's Drive, Bldg. 300
Santa Fe, NM 87505

/s/ John B. Pound
JOHN B. POUND

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs. **No. 04-26 CV**

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant,

MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION TO COMPEL NO. 1 – DOCUMENTS RELATED TO THE FORMATION OF SALES CONTRACTS, THE VALUE AND PRICES OF UNIT CO_2

I. INTRODUCTION

This case involves the business of using carbon dioxide ("CO_2") by oil companies for enhanced recovery of oil and gas in Permian Basin fields in West Texas and Southeast New Mexico. Plaintiffs and the class own royalties and overriding royalties on the CO_2 produced in the Bravo Dome Carbon Dioxide Gas Unit in Northeastern New Mexico (the "Unit"). Defendant ("Kinder-Morgan") holds oil and gas lessee working interests in the Unit requiring the payment of royalty on CO_2 that is compressed, delivered by pipeline and injected in certain Permian Basin oil fields.

Plaintiffs have sued Kinder-Morgan in this action for underpayment of CO_2 royalties in violation of the

settlement agreement reached between members of the plaintiff class and the various defendants in litigation styled *Doris Feerer, et al. v. Amoco Production Company, et al.*, U.S.D.C. No. 95-0012, referred to herein as the Feerer Settlement Agreement. Kinder-Morgan is a party to that Agreement (f/k/a Shell CO2 Company Ltd.).

Kinder-Morgan and a few other oil companies dominate the production, transportation and use of CO_2 from the Unit and from the McElmo Dome Unit and Sheep Mountain Units, the other natural sources of CO_2 for Permian Basin enhanced oil recovery. Defendant produces CO_2 from the Unit and from McElmo Dome as do Oxy USA and Exxonmobil. They transport it through pipelines which they own to enhanced oil recovery ("EOR") projects in West Texas and Lea County, New Mexico. Kinder-Morgan owns and operates major interests in EOR projects where the compressed CO_2 is injected by it into oil reservoirs in order to achieve otherwise unrecoverable oil production. The sole reason for existence of these source fields, such as the Bravo Dome, is production of CO_2 for enhanced oil recovery. The true value of and demand for the CO_2 is directly related to the amount and price of oil that it can incrementally cause to be recovered and sold. Kinder-Morgan derives handsome economic benefits from its pipeline transportation charges and from the use of the CO_2 through increased production and sales of oil from its EOR projects. That is even more dramatically the case because of the historically high oil prices prevailing during 2000 to the present.

There are three basic links in the value chain of the CO_2: (a) production in the Unit; (b) pipeline transportation from the Unit to the Permian Basin oil fields; (c) enhanced oil and gas production and sale. It is only the revenue

attributed to the first link, CO_2 production in the Unit, which has to be shared with the plaintiffs in the form of royalty and overriding royalty (and with the State of New Mexico for severance taxes). It takes no Ph.D. in economics to understand the financial consequence to the defendant of minimizing the revenue attributable to production at the Unit and allocating revenues and profits to the other two links in the value chain.

In this case, plaintiffs' Class Action Complaint alleges that defendant has underpaid royalties owed to the members of the class by various schemes for depressing the CO_2 prices thereby minimizing expense and increasing defendant's profits in its EOR projects. Plaintiffs believe one scheme involves the creation of sham purchase and sale contracts for CO_2 between Kinder-Morgan and other companies who own and produce CO_2, all of whom use CO_2 in their EOR projects.

Kinder-Morgan represents in various public documents that it utilizes large volumes of the CO_2 from McElmo Dome and the Bravo Dome Unit in its owned EOR projects, primarily SACROC and the Yates Field in West Texas. See documents attached hereto as Exhibit A. Nevertheless, and despite the fact that Kinder-Morgan requires its own CO_2 produced from the Bravo Dome Unit for its own EOR projects, it enters into "contracts" with CO_2 producers and EOR users Oxy USA, Inc., ExxonMobil Corporation, and Amerada Hess Corporation, whereby it purports to "sell" the CO_2 it produces from the Bravo Dome Unit to these other companies.

If the companies simply took and used their share of the CO_2 in-kind there would be no contracts setting prices. In that case the pricing of the in-kind volumes would be

patently suspect. So plaintiffs believe the scheme is one of "you sell to me and I to you and we will fix desired prices for royalty and taxes." It is unclear how much gas actually flows between seller and buyer under these contracts.

Defendant's rigging of artificially low "prices" – below the actual, fair market value of the Unit CO_2 – is a breach of its express and implied obligations under the Feerer Settlement Agreement. That is not an arbitable [sic] issue.

Pursuant to these claims, plaintiffs have requested that the defendant produce documents in four general categories at issue here: (1) documents related to the defendant's EOR projects, including the volumes of Unit CO_2 injected, recovered and re-injected, income generated by Unit CO_2 injection and recycling operations, and increased oil production, income and profits from the EOR projects as a result of the CO_2 operations; (2) documents related to the circumstances surrounding the contracts which form the basis of the computation and payment of royalties to those Unit royalty owners who are members of the class; (3) documents related to pricing of CO_2 relevant to a determination of the proper royalty payment; and (4) documents reflecting Kinder-Morgan's share of CO_2 volumes from the Unit and other CO_2 units in which it owns an interest.

Several categories of documents relate to the economics attendant to the use of CO_2 and are therefore directly relevant to the core of plaintiff's claims. The requested documents should also show how Kinder-Morgan has formed contracts for the sale of Unit CO_2, whether the contracts are arms-length, whether the contracts are actually an exchange of CO_2 mechanism, whether Kinder-Morgan has artificially depressed the price of CO_2 in order

to minimize its royalty payment obligations, and whether Kinder-Morgan has conspired with other CO_2 royalty obligors to administer the prices of Unit CO_2. The evidence will also assist the plaintiffs and eventually the trier of fact in calculating a proper value for the CO_2.

On September 10, 2004, plaintiffs served Kinder-Morgan, with Plaintiffs' First Requests for Production of Documents. A copy is attached as Exhibit B. Plaintiffs requested the production of twenty-one categories of documents. Kinder-Morgan filed on October 4, 2004, a motion to stay discovery until the Court rules on Kinder-Morgan's Motion to Compel Arbitration. Attached to that Motion are monthly summary spreadsheets which reflect some the data and the math used by Kinder-Morgan to derive royalty payments.

Kinder-Morgan has agreed to produce documents that it unilaterally decides have a bearing on the Motion to Compel Arbitration. Pursuant to Kinder-Morgan's agreement to produce a limited number of documents, plaintiffs proposed a compromise on November 1, 2004 regarding the outstanding document requests. See letter attached as Exhibit C. Specifically, plaintiffs proposed that, if Kinder-Morgan produced documents responsive to document requests 10, 11(d), and 12-16, plaintiffs would not seek to compel production of the other requests until after the Court resolves Kinder-Morgan's motion to arbitrate.

On November 11, 2004, Kinder-Morgan responded, refusing to produce any documents relating to document requests 10, 11(d), and 12-16 and claiming, among other things, – that "we believe such requests are overbroad and seek information that has no bearing on the royalty issue." See letter attached as Exhibit D. Rather than respond to

the production requests specifically, Kinder-Morgan announced that it would turn over narrow categories of documents relating to (1) contracts Kinder-Morgan used to determine prices/values for royalty payments (which plaintiff already had received), (2) spreadsheets containing royalty calculations (which duplicate the documents attached as exhibits to the Motion to Compel Arbitration) and (3) certain underlying documents used to determine net-back volumes referenced in the royalty calculation spreadsheets. In so doing, Kinder-Morgan agreed only to produce documents that have, as Kinder-Morgan wrote, a "bearing on the royalty calculation issue." The objections also include relevance, overbreadth, and vagueness. See Responses and Objections, attached as Exhibit E.

The letter of November 11, 2004, brings into sharp focus the difference between the parties. Kinder-Morgan is willing to reveal some contracts and how it mathematically applies volumes of CO_2 to contract terms to "calculate" royalty. Of course, royalty "calculation" follows mechanically from the CO_2 prices and it is those "prices" from suspect contracts which are the real bone of contention. Plaintiffs challenge the very validity and economic rationality of the numbers that Kinder-Morgan uses. Plaintiffs also observe facts in the public domain and in the limited discovery to infer that some, if not all, Kinder-Morgan's CO_2 sales contracts are actually made pursuant to an agenda to circumvent the *Feerer* Settlement Agreement terms and to provide cover for its Bravo Dome and McElmo Dome CO_2 used in-kind. **In short, Kinder-Morgan wants to limit the investigation to its mechanical calculations and plaintiffs want to go deep behind the numbers used in the calculation.**

II. ARGUMENT

A. The Discovery Standard

In New Mexico, the "pretrial discovery rules, including Rule 26, intend a liberal pretrial discovery, to enable the parties to obtain the fullest possible knowledge of the facts before trial. Notwithstanding objection to the [requested discovery], the presumption is in favor of discovery." *Marchiondo v. Brown,* 98 N.M. 394, 397, 649 P.2d 462, 465 (1982). *Accord Lewis v. Samson*, 1999 NMCA 145, 128 N.M. 269, 276, 992 P.2d 282, 289 (Ct. App. 1999). The Supreme Court has noted that this liberal scope of discovery is as broad under Rule 1-034, respecting the production of documents, as it is under Rules 1-026 and 1-033. *Davis v. Westland Dev. Co.*, 81 N.M. 296, 299, 466 P.2d 862, 865 (1970). In *United Nuclear Corp. v. Gen. Atomic Co.,* 96 N.M. 155, 174, 629 P.2d 231, 250 (1980), the Supreme Court also noted:

> 'Objections based on alleged irrelevancy must, therefore, be viewed in light of the broad and liberal discovery principle consciously built into' the rules of civil procedure. . . . Because courts 'are not shackled with strict interpretations of relevancy,' . . . discovery is permitted as to matters that 'are or may become relevant' or 'might conceivably have a bearing' on the subject matter of the action, or where there is 'any possibility' or 'some possibility' that the matters inquired into will contain relevant information.

Id. (citations omitted) (footnotes omitted).

A party opposing discovery has the burden of proving that the requested discovery should be disallowed. *Josephs v. Harris Corp.*, 677 F.2d 985 (3rd Cir. 1982); *Roseberg v. Johns-Manville Corp.*, 85 F.R.D. 292 (E.D. Pa. 1980). A

mere statement by a party that a request for production is overly broad, burdensome, oppressive and irrelevant is inadequate to voice a successful objection. *Id.* The party resisting discovery must show specifically how each request is not relevant, or how each question is overly broad, burdensome or oppressive. *Oleson v. K-Mart Corp.*, 175 F.R.D. 560 (D. Kan. 1997); *Peat, Marwick, Mitchell & Company v. West*, 748 F.2d 540 (10th Cir. 1984).

Kinder-Morgan's objections to relevance, overbreadth and vagueness are merely standard, stock objections to discovery, unsupported by any proof. Consequently, the Court should rule that the stock objections are invalid and do not support Kinder-Morgan's refusal to produce relevant documents.

B. The Documents Requested Are Discoverable

1. The Issue Posed by Kinder Morgan's Motion to Compel Arbitration

Kinder-Morgan's Motion to Compel Arbitration is based on Section 16 of the Feerer Settlement Agreement. The arbitration provision is narrowly drawn. It pertains only to disputes regarding prices in Non-Qualified Contracts and Non-Qualified Other Transportation Charges. Plaintiffs' dispute prices under Non-Qualified Contracts, but they do so within the challenge to the overall policy by Kinder-Morgan and others to circumvent the Settlement Agreement and to artificially depress the payments to the royalty owners.

The primary thrust of the complaint is that Kinder-Morgan has breached the Feerer Settlement Agreement in the manner and method by which it fails to honor its royalty obligations. The Settlement Agreement expressly

excludes future claims for breach of the Settlement Agreement from the arbitration provision. None of the claims articulated in the Class Action Complaint are expressly reserved for arbitration in the Settlement Agreement. Similarly, plaintiffs' complaint regarding the net-back pricing methodology Kinder-Morgan utilizes to determine royalty obligations is not subject to the arbitration provision of the Feerer Settlement Agreement.

While the class action lawsuit in this case attacks the price upon which Kinder-Morgan calculates royalties, and while that price involves, to some extent, the price for sales under Non-Qualified Contracts, the attack on Kinder-Morgan's royalty payments is much broader. The "price" under contracts made with other CO_2 producers/ injectors is inextricably intertwined with the challenged conduct.

Kinder-Morgan's objection to the requests for production served by plaintiffs rests upon the pendency of its Motion to Compel Arbitration. Plaintiffs have previously established why the narrow, limited arbitration provision in the *Feerer* Settlement Agreement does not compel arbitration of the claims in this class action lawsuit. Even if the Court were to ultimately determine that some narrow issues are arguably within that arbitration provision, this case in its entirety must ultimately be presented to a jury as the trier of fact for a determination as to whether Kinder-Morgan breached the *Feerer* Settlement Agreement by failing to pay royalties on a proper valuation for CO_2 produced from the unit. Such claims are expressly excluded from arbitration under paragraph 16 of the *Feerer* Settlement Agreement. Consequently, there is no justifiable basis for Kinder-Morgan to object to the

subject discovery because of its pending Motion to Compel Arbitration.

2. Kinder-Morgan's Scheme to Depress Royalty Payments.

Under the *Feerer* Settlement Agreement, Kinder-Morgan is obligated to pay a "proper" royalty for CO_2 produced from the Bravo Dome Unit. Under that agreement, the parties specified that prices received under specifically enumerated contracts (Qualified Contracts) were appropriate or proper. With respect to other contracts, called "Non-Qualified Contracts" under the *Feerer* Settlement Agreement, the parties reserved judgment on whether the prices and royalty based thereon were proper. Given the covenant of good faith it must be assumed that the intent of that provision was to cover legitimate, arm's length Non-Qualified Contracts.

There is no express formula in the Settlement Agreement for determining whether a price is or is not proper. The logical measure of the CO_2 value, however, is the value of the crude oil and natural gas that but for the CO_2 would remain in the ground.

Following execution of the *Feerer* Settlement Agreement in April 1998, Kinder-Morgan has entered into numerous contracts for the "sale" of CO_2 produced from the Unit and amended other contracts. The sales are primarily made to other operators who also own CO_2 production in the Bravo Dome Unit and the McElmo Dome Unit in Southwest Colorado. Each of them have need for their CO_2 in their own EOR projects. The evidence produced to date points to some sales as being subterfuges by which the sellers end up with the CO_2, a fungible commodity that is

transported from all source fields to a single central pipeline hub at Denver City. The commingled CO_2 from McElmo Dome, Sheep Mountain and Bravo Dome is then transported by lateral lines to various EOR projects. There seems to be no commercial rationale for Kinder-Morgan to sell CO_2 which it needs for its own EOR projects. No rationale that it is other than a means for the CO_2 producers to circumvent the Settlement Agreement and fix the prices for royalty and tax payment purposes.

When Kinder-Morgan sells all its CO_2 it then has to "purchase" from the same companies it is "selling to" in order to secure an adequate supply of CO_2 for its SACROC and Yates Field Projects. The available evidence suggests that these "contracts" are in fact attempts by various CO_2 producers to artificially deflate the price of CO_2 upon which they then pay royalties. This is possible because the primary CO_2 producers Kinder-Morgan, Oxy, ExxonMobil and Amerada Hess Corporation are also the primary end users of CO_2 for oil production.

In addition, documents Kinder-Morgan has produced to date already confirm that there are irregularities in Kinder-Morgan's accounting process. For instance, the June, 2000 Post Settlement statement attached as an exhibit to Kinder-Morgan's Motion to Compel Arbitration shows two categories of sale to Amerada Hess, one under contract 34625-202E, and one under 34625-223A. On the Post Settlement sheet, Kinder-Morgan represents that no volumes were included under either contract. As to 202E, Kinder-Morgan represents that it is "not included in royalty calculation because Cross Timbers took product from Bravo and sold to KM." As to 223A, a zero volume is depicted. See documents attached hereto as Exhibit F. However, attached hereto as Exhibit G is an invoice from

Kinder-Morgan to Amerada Hess for the delivery of CO_2 to the Seminole San Andres Unit ("SSAU"), under the same meter number, 34625,[1] for a volume of 154,497 Mcf of CO_2, for a total amount due of $165,761.84.

Kinder-Morgan has gamed the system to derive an artificially low price for the gas at the Unit. At its EOR projects Kinder-Morgan injects CO_2. It could (and in reality does) inject its own CO_2 ("in-kind supplies") which generally amount to the major portion of the volumes used. Since Kinder-Morgan and other Unit working interest owners are using their own commodity the only significance of CO_2 "prices" under the various contracts appear to be to provide a measure for royalty and taxes.

The obvious incentive of the defendant is to keep the CO_2 "price" low. Not only does Kinder-Morgan steadfastly argue that those prices they concoct, less deductions for their own charges for mainline transportation services, are the proper measure of royalty, it even contends by its discovery objections that those "prices" are the be all and end all of relevant evidence. In other words, Kinder-Morgan's relevancy objection says that the plaintiffs, the Court and the jury are only entitled to evidence Kinder-Morgan selects to produce, calculation summary sheets and the contracts. This approach deprives plaintiffs' of evidence which will support plaintiffs' theory of proper CO_2 value and of the nonarbitrability of the issues in this case.

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[1] The number 34625 appears to designate the measurement meter at the tailgate of the Bravo Dome Unit compression plant while 202E and 2223A are contract identifiers.

3. Documents Related to Kinder-Morgan's EOR Protects are Discoverable.

Request No. 10 seeks documents regarding sales of CO_2 from McElmo Dome, another CO_2 unit, as well as contracts related to such sales. Kinder-Morgan owns a 45% interest in the CO_2 in McElmo Dome, which it needs for its EOR projects.

Request No. 11 seeks any contract for CO_2 produced for any EOR project which references a sale of CO_2 by Kinder-Morgan.

Request No. 12 seeks the production of contracts concerning unit produced and McElmo Dome produced CO_2. It seeks evidence of in-kind delivery and of CO_2 delivered to the SACROC Unit from Kinder-Morgan before the defendant became 80% owner and operator of that granddaddy EOR field. Request No. 15 seeks documents reflecting CO_2 delivered or sold to Altura-operated EOR projects. Altura is the entity that operates certain of Oxy USA's EOR fields.

All of these requested documents are relevant, to help establish the true value for CO_2 upon which royalties should be paid. Moreover, these documents are relevant to demonstrate the manner and method by which Kinder-Morgan and other CO_2 royalty obligors circumvent and breach the Settlement Agreement. The contracts between the CO_2 producers/users are subject to attack as to their very legitimacy, not just as to the facial price.

Because of the absence of a workable market and a lack of arms' length transactions, the economics of the Unit, as well as of Kinder-Morgan's EOR projects must all be examined. Evidence of any arms length sales to third

parties that do reflect a seller and buyer with true competing economic interests would also be relevant. That evidence is being sought by plaintiffs.

By analogy cases recognizing that where self-dealing among dominant working interest owners and their affiliated companies is shown the royalty calculation is not limited to the proceeds derived from non-arms' length transactions are applicable. For example, in *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24 (Tex. App. – Texarkana 1984), *vacated pursuant to settlement*, 760 S.W.2d 960 (Tex. 1988), the Texas Court of Appeals held that the price paid by the lessee's wholly owned subsidiary for gas sold at the well was not controlling for purposes of a royalty clause based on "amount realized" from such sale, affirming the trial court's finding that "the purported sale of the gas to [the subsidiary] was a sham, and that [the lessee] used that arrangement and its relationship with its wholly owned subsidiary to create an unfair device to deprive plaintiffs of their rightful royalties." *Id.* at 28. The court further held that the royalty owners thus "were entitled to recover as actual damages the difference between what they had paid and the market value of the gas. . . ." *Id.* at 29.

Similarly, in *Wegman v. Central Transmission, Inc.*, 499 So. 2d 436, 441, 443, 448-49 (La. Ct. App. 1986), the Louisiana Court of Appeals held that the prices at which the lessees sold gas at the well to their affiliated company under contracts that "were not 'arms-length agreements,'" but which "created an artificial market value for gas," were therefore not controlling for purposes of computing royalty under an "amount realized" royalty clause; and the royalty owners were entitled to royalties based on actual market value, which was proven by expert testimony.

It is therefore clear that this case involves a search for the truth behind the Non-Qualified Contracts as well for the true market value of the CO_2 from the Unit. And, given that the Unit CO_2 is primarily used to increase oil production in defendants' EOR projects, the revenues, expenses and profits generated by those projects have a direct bearing on the CO_2's value and are therefore relevant. The Tenth Circuit, for example, has recognized that the value of a product or property can be determined by analyzing the income generated by its use. *U.S.A. v. 179.26 Acres of Land,* 644 F.2d 367, 372 (10th Cir. 1981); *Sill Corp. v. U.S.A.,* 343 F.2d 411, 416 (10th Cir. 1965) ("[T]he law is not wedded to any particular formula or method for determining fair market value . . . ")

Where, as here, there is no established market for the commodity, the courts have been especially willing to look to every relevant factor and alternative methods for determining value, including income and other factors related to the use of the product. In *Sartor v. Arkansas National Gas Corp.,* 321 U.S. 620, 622 (1944), the Supreme Court stated, "if there is no market price at the well for the gas, [the inquiry shall determine] what it is actually worth there, and 'in determining this actual value . . . every factor properly bearing upon its establishment should be taken into consideration.'" In New Mexico law a consideration in ascertaining the fair market value of property is the use for which the property is suitable. *McCanna v. Burke, Trustee*, 197 B.R. 333, 1996 U.S. Dist. LEXIS 9133 (D.N.M. 1996); UJ1 13-711.

In *Katschor v. Eason Oil Co.*, 63 P.2d 977, 981 (Okla. 1936), the Oklahoma Supreme Court held that, under a market value royalty clause for casinghead gas used by the lessee in its gasoline plant, because there was no

established market price for casinghead gas, the royalty should be based on the "actual value" of the gas, which the royalty owners could prove based on the price paid to the lessee for the gasoline manufactured using the casinghead gas.

4. Documents Involving Communications Between Kinder-Morgan and Other Working Interest Owners that Refer to Pricing of CO_2 are Relevant.

Request No. 13 seeks all internal Kinder-Morgan files, as well as documents referencing communication between Kinder-Morgan and third parties that "reflect, discuss, refer to or concern the pricing of Unit CO_2 and the method of calculating royalty payments to any unit lessor or overriding royalty holder." The relevance of these documents is self-evident. Plaintiffs are entitled to all documents in Kinder-Morgan's possession related to this issue, since internal file documents and communications with third parties may well confirm plaintiffs' charge that Kinder-Morgan is intentionally undervaluing the CO_2 for royalty calculation purposes. Indeed, these documents clearly have a bearing on the royalty calculation, and are documents which Kinder-Morgan had agreed to produce in principle.

Request No. 14 is particularly meaningful in that subparts (b) and (c) seek to uncover communications between Kinder-Morgan and other working interest owners in Bravo Dome and McElmo Dome about valuing CO_2 and making their transactions that superficially are sales but actually are exchanges of the gas. Subpart (d) calls for economic studies or models concerning the pricing

of CO_2 in relation to return on investment and economics of EOR projects.

Kinder-Morgan has produced some contracts. More importantly, however, plaintiffs are entitled to all documents which underlie and surround the formation of those contracts. Starting with documents and then progressing to deposing witnesses the facts must be out on how the contracts were negotiated, the reality of the sales or exchanges, how the prices were determined, whether there was collusion or price setting by Kinder-Morgan and other royalty obligors, all in order to allow plaintiffs to fully investigate the CO_2 sales (if they are sales). Any studies, analyses or models that deal with the pricing of CO_2 are clearly relevant to the central issue and to allow the plaintiffs and the factfinder in this case to compare these analyses and models with the actual prices that Kinder-Morgan has used to calculate royalties.

Request No. 16 is similarly relevant. That request seeks documents in the form of bids, offers or proposals to sell or otherwise supply CO_2 to third parties for use in EOR projects and requests for proposals, requests for bids or inquiries from the working interest owners in EOR projects to Kinder-Morgan about the purchase or delivery of CO_2. These documents can provide interesting information such as sales to parties who have no CO_2 of their own as opposed to sales to the likes of other large CO_2 producers. They may demonstrate the true nature of some of sales contracts and demonstrate that Kinder-Morgan has joined with others to administer prices to fit their financial objectives.

III. CONCLUSION

Based on the foregoing points and authorities, plaintiffs respectfully request that the Court enter its Order compelling Kinder-Morgan to produce all documents responsive to Requests 10-16, and for such further relief as the Court deems proper.

Respectfully submitted,

GALLEGOS LAW FIRM, P.C.

By /s/ J.E. Gallegos
J.E. GALLEGOS
MICHAEL J. CONDON
460 St. Michael's Drive, Bldg. 300
Santa Fe, New Mexico 87505
(505) 983-6686

SUSMAN GODFREY, LLP
THOMAS W. PATERSON
NM Bar No. 16891
1000 Louisiana, Suite 5100
Houston, Texas 77002-5096
(713) 653-7815
(713) 654-3392 (fax)

CERTIFICATE OF SERVICE

I hereby certify that I have caused a true and correct copy of the foregoing Memorandum in Support of Plaintiffs' Motion to Compel No. 1 – Documents Related to the Formation of Sales Contracts, the Value and Prices of Unit

CO2 to be served on this 10th day of December, 2004, to the following counsel of record:

John Pound
Long, Pound & Komer PA
2200 Brothers Rd.
Santa Fe, NM 87501

VIA HAND-DELIVERY

Andrew McCollam, III
Richard H. Page
Vinson & Elkins, L.L.P.
2300 First City Tower
1001 Fannin Street
Houston, TX 77002-6760

VIA U.S. MAIL

/s/ J.E. Gallegos
J.E. Gallegos

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

DORIS FEERER, MARTIN BROTHERS, a partnership, J. CASPER HEIMANN, MALCOLM SMITHSON, and CHRISTINE SMITHSON, his wife,	§	
Plaintiffs,	§	
vs.	§	Civ. No. 95-0012 JC/WWD
AMOCO PRODUCTION COMPANY, AMERADA HESS CORPORATION, SHELL WESTERN E&P INC., and EXXON CORPORATION,	§	
Defendants.	§	

CLASS ACTION SETTLEMENT AGREEMENT

(Filed Apr. 1, 1998)

It is hereby stipulated and agreed between the Plaintiffs Doris Feerer, Martin Brothers, J. Casper Heimann, and Malcolm and Christine Smithson, individually and on behalf of the Class (as hereinafter defined), on the one hand, and Defendants Amoco Production Company, Amerada Hess Corporation, Shell Western E&P Inc., and Exxon Corporation, as well as Shell CO2 Company Ltd. (which is not a party to the Action), on the other, through their, duly authorized counsel or representatives, and subject to court approval in accordance with the procedures described herein and pursuant to the applicable Federal Rules of Civil Procedure, as follows:

A. BACKGROUND

1. Plaintiffs, on behalf of themselves and the Class, filed a lawsuit on January 5, 1995, against Defendants Amoco Production Company, Amerada Hess Corporation, Shell Western E&P Inc., and Exxon Corporation in the United States District Court for the District of New Mexico, styled *Doris Feerer, et al. v. Amoco Production Company, et al.*, Civil Action No. 95-0012JC/WWD, asserting claims based on alleged violations of antitrust laws, breach of contract, breach of duty of good faith and fair dealing, breach of implied covenant to market, fraud, negligent misrepresentation and unjust enrichment. The claims asserted by the Plaintiffs in the Action on behalf of themselves and the Class are more fully set forth in the Original and the First, Second and Third Amended Complaints, copies of which are attached as Exhibit A (hereinafter collectively the "Complaints").

2. The Defendants have each filed answers to the Complaints, denying any and all allegations of wrongdoing set forth therein, and alleging certain affirmative defenses. Copies of each of the Defendants' answers to the Third Amended Complaint are on file with the Court in the Action.

3. Before and after the filing of this Action, Class Counsel (as hereinafter defined) conducted extensive formal and informal discovery and investigation. This discovery and investigation has included, *inter alia*, (a) the inspection of hundreds of thousands of pages of documents produced by Defendants and third parties; (b) the promulgation and response to numerous written discovery requests, including interrogatories, requests for production of documents, and requests for admissions; (c) the taking

and defense of approximately one hundred (100) depositions; (d) the engagement of numerous experts to analyze various issues, who have prepared extensive reports; (e) the preparation and review of hundreds of pleadings filed in the Action; and (f) research of applicable law with respect to the claims asserted in the Action and the potential defenses thereto.

4. Class Counsel believe that the claims asserted in the Action have merit and are supported by the evidence developed to date. Class Counsel, however, recognize and acknowledge the risks and uncertainties inherent in prosecuting any action and the expense and length of continued proceedings necessary to prosecute this Action against Defendants through trial and appeals. Class Counsel believe that the Settlement set forth in this Agreement confers substantial and significant benefits to the Class. Accordingly, based upon their evaluation and as a result of arms length negotiations with Defendants, which have been conducted both formally and informally and pursuant to settlement conferences, Class Counsel have determined that the terms and conditions of this Settlement are fair, reasonable, adequate, and in the best interests of the Class.

5. Defendants vigorously contest and continue to deny each and all of the claims and contentions alleged by the Plaintiffs and the Class, which Defendants assert are without merit. The Defendants vigorously deny that they have violated any law or regulation, or breached any agreement or duty, or are in any way liable to the Plaintiffs or any member of the Class. Defendants believe that the evidence developed to date does not support the claims of Plaintiffs and the Class and that the affirmative defenses they have asserted are supported by the evidence.

Nevertheless, the Defendants have entered into this Agreement solely because they believe it will avoid the further substantial expenses, inconvenience and distraction of continued litigation. Defendants have also taken into account the uncertainty and risks inherent in any litigation, especially in complex cases like this Action. Defendants have, therefore, determined that it is desirable and beneficial that the Action be settled in the manner and upon the terms and conditions set forth in this Agreement.

6. Accordingly, subject to court approval in accordance with the procedures described hereinafter and pursuant to the applicable rules of procedure, the Parties agree to settle and dispose of this Action on the terms and conditions hereinafter set forth.

* * *

9. As a part of the consideration for this Settlement, the Parties further agree, as between each Defendant and its Respective Owners to the following provisions with respect to Unit Compression, Dehydration, and Gathering for purposes of determining their respective royalty settlement values and payment of royalty to their Respective Owners:

9.1 Effective for production of Unit CO2 occurring on July 1, 1997 and thereafter, Exxon shall not deduct any costs of Unit Compression, Dehydration and Gathering in calculating royalty payments to Exxon Owners.

9.2 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, Amoco, Hess, and Shell shall not deduct any costs of Unit Compression, Dehydration, and

Gathering in calculating their respective royalty payments to their Respective Owners.

9.3 Pursuant to paragraphs 9.1 and 9.2, and after the applicable time period begins, Defendants shall not adjust or reduce their respective royalty payments to their Respective Owners for costs of Unit Compression, Dehydration and Gathering by any method, direct or indirect, As example only, for Unit CO2 that undergoes Unit Compression, Dehydration and Gathering, Defendants shall not calculate their respective royalty settlement values for royalty payments to their Respective Owners on the basis of a sale or delivery point at the physical locations of the wellheads on the Unit or at a point otherwise upstream of the Unit Tailgate. As further example only, if any of the Defendants sell Unit CO2 and the buyer is separately charged for Unit Compression, Dehydration and Gathering, the amount of payment received by any Defendant for such Unit Compression, Dehydration, or Gathering activities shall not be excluded from the amounts received for the sale of the Unit CO2 for the purpose of calculating royalty due to such Defendant or Defendants' Respective Owners. As further example only, costs of Unit Compression, Dehydration and Gathering shall not be included as a part of any deduction associated with the transportation of Unit CO2 for the purpose of calculating royalty due to the Defendants' Respective Owners.

10. Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, for purposes of determining their respective royalty settlement values and payment of royalty to their Respective Owners, Defendants shall not, directly or indirectly, deduct a marketing fee. The foregoing also means, as example only, that Amoco shall not deduct a marketing fee in calculating the sales

price under the Amoco Production-Amoco Oil Contract, Nothing herein shall constitute an acknowledgment that any marketing fee has been charged in the past by Exxon or Shell.

11. Effective as of the identified dates, the following provisions shall govern the transportation deductions specified below, for purposes of the indicated Defendant's determinations of their respective royalty settlement values and payment of royalty to their Respective Owners:

11.1 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, and only for purposes of Amoco calculating royalty payments to Amoco Owners (subject to paragraph 17), the following provisions shall govern the specified deductions or adjustments for mainline transportation of Unit CO2 in the Bravo Pipeline System:

(a) With respect to volumes of Unit CO2 taken by Amoco attributable to its working interests in the Unit, whether equal to, less than or more than its entitlements, and transported on space in the Bravo Pipeline System owned by Amoco or its Affiliates. (including without limitation Bravo Pipeline Company and Altura Energy, Ltd.), or successors, successors-in-interest and assigns which are Amoco Affiliates (hereafter collectively the "Amoco Companies"), from the Unit Tailgate to the Terminus Point, or to any point between the Terminus Point and a point 75 miles upstream of the Terminus Point, Amoco shall be entitled to deduct for such transportation the lesser of (i) 11¢ per mcf, or (ii) the tariff or amount actually charged for the Amoco Companies' space in the Bravo Pipeline System (hereinafter the "Amoco Approved Mainline Deduction"). The Amoco Approved Mainline Deduction shall be inclusive of all

services and charges (such as, as example only, charges for the Lost Draw Booster Station) that have been historically treated as a part of the Bravo Pipeline mainline tariff previously charged for transportation of Unit CO2 from the Unit Tailgate to the Terminus Point. The Amoco Approved Mainline Deduction shall not be inclusive of any service or charge that historically has not been treated as part of the Bravo Pipeline mainline tariff previously charged for transportation of Unit CO2 from the Unit Tailgate to the Terminus Point.

(b) With respect to volumes of Unit CO2 taken by Amoco attributable to its working interests in the Unit, whether equal to, less than or more than its entitlements, and transported on the Amoco Companies' space in the Bravo Pipeline System to a delivery point or points on such pipeline located more than 75 miles upstream of the Terminus Point, then the 11¢ per mcf limitation (or the lesser tariff or amount actually charged) in (a) above shall be reduced by the ratio that the distance in miles from the origination point of the Bravo Pipeline System to the delivery point bears to the distance in miles from the origination point of the Bravo Pipeline System to the point 75 miles upstream of the Terminus Point, and such reduced amount shall be utilized in lieu of the 11¢ limitation (or the lesser tariff or amount actually charged) provided for in subparagraph 11.1(a) above.

(c) The above provisions mean, as example only, that, for purposes of calculating its royalty settlement values for royalty payments to Amoco Owners for Unit CO2 taken by Amoco attributable to its working interests in the Unit, whether equal to, less than or more than its entitlements, and transposed on the Amoco Companies' space in the Bravo Pipeline System, Amoco shall not deduct a Bravo Pipeline mainline tariff greater than 11¢ per mcf for deliveries

to the Terminus Point in calculating the sales price of Unit CO2 under the Amoco Production-Amoco Oil Contract, or deduct for mainline transportation on the Bravo Pipeline System an amount greater than the Amoco Approved Mainline Deduction for hauls to the Terminus Point or greater than the reduced Amoco Approved Mainline Deduction (For hauls to a point or points more than 75 miles upstream of the Terminus Point).

11.2 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, and only for purposes of Hess and Shell calculating royalty payments to Hess' and Shell's Respective Owners (subject to paragraph 17), the following provisions shall govern the specified deductions or adjustments for transportation of Unit CO2 in the Rosebud/Sheep Mountain Pipeline and the Bravo Pipeline System:

(a) With respect to volumes of Unit CO2 taken by Hess or Shell attributable to their respective working interests in the Unit, whether equal to, less than or more than their respective entitlements, and transported (i) on space in the Rosebud/Sheep Mountain Pipeline owned by Hess or its Affiliates, or successors, successors-in-interest and assigns which are Hess Affiliates (hereafter collectively the "Hess Companies"), from the Unit Tailgate to the Seminole San Andres Unit ("SSAU") or to any point between SSAU and a point located on the Rosebud/Sheep Mountain Pipeline seventy-five (75) miles upstream of the Terminus Point (as to Hess volumes), or (ii) on space in the Bravo Pipeline System owned by Shell or its Affiliates (including without limitation Shelf Western Pipelines Inc.) or Altura Energy, Ltd., or successors, successors-in-interest and assigns which are Shell Affiliates (hereafter collectively the "Shell Companies"), from the Unit Tailgate to the Terminus Point or to

any point between the Terminus Point and a point 75 miles upstream of the Terminus Point (as to Shell volumes), a mainline transportation deduction of 11¢ per mcf shall be utilized (hereinafter the "Hess/Shell Approved Mainline Deduction"), The Hess/Shell Approved Mainline Deduction shall be inclusive of all services and charges (such as, for example only, charges for the Lost Draw Booster Station as to the Bravo Pipeline System) that have been historically treated as the mainline deduction or charge previously applied with respect to Unit Tailgate to SSAU transportation (with respect to Hess' space in the Rosebud/Sheep Mountain Pipeline) and the Unit Tailgate to the Terminus Point transportation (with respect to the Shell Companies', space in the Bravo Pipeline System). The Hess/Shell Approved Mainline Deduction shall not be inclusive of any service or charge that historically has not been treated as part of the mainline deduction or charge previously applied with respect to Unit Tailgate to SSAU transportation (with respect to Hess' space in the Rosebud /Sheep Mountain Pipeline) and Unit Tailgate to the Terminus Point transportation (with respect to the Shell Companies' space in the Bravo Pipeline System).

(b) With respect to (i) volumes of Unit CO2 taken by Hess attributable to its working interest in the Unit, whether equal to, less than or more than its entitlements, and transporter on the Hess Companies' space in the Rosebud/Sheep Mountain Pipeline, or (ii) volumes of Unit CO2 taken by Shell attributable to its working interest in the Unit, whether equal to, less than or more than its entitlements, and transported on the Shell Companies' space in the Bravo Pipeline System to a delivery point or points on such pipelines located more than 75 miles upstream of the Terminus Point, then the Hess/Shell Approved Mainline Deduction shall be

reduced by the ratio that the distance in miles from the origination point of the Rosebud/Sheep Mountain or the Bravo Pipeline System to the delivery point bears to the distance in miles from the origination point of the pipeline to the point 75 miles upstream of the Terminus Point on such pipeline, and such reduced Hess/Shell Approved Mainline Deduction shall be utilized in lieu of the 11¢ provided for in subparagraph 11.2(a) above.

(c) The above provisions mean, as example only, that Hess and Shell shall not, for purposes of calculating their respective royalty settlement values, deduct for mainline transportation with respect to volumes taken by Hess or Shell attributable to their respective working interests, whether equal to, less than or more than their respective entitlements, and transported in the Hess Companies' or the Shell Companies' respective space, as applicable, in the Rosebud/Sheep Mountain or the Bravo Pipelines, in an amount greater than the Hess/Shell Approved Mainline Deduction for hauls to the Terminus Point (or for hauls to SSAU, in the case of Hess) or greater than the reduced Hess/Shell Approved Mainline Deduction (for hauls to a point or points more than 75 miles upstream of the Terminus Point).

11.3 Amoco, Hess and Shell may not avoid the limitations in paragraphs 11.1 and 11.2 by entering into transactions within the scope of paragraphs 11.1 and 11.2: (a) with their respective Affiliates or, as to Shell, Altura Energy, Ltd., which result in a greater effective transportation deduction or differential than those approved under paragraphs 11.1 and 11.2; or (b) with non-Affiliates which (i) are designed to avoid or circumvent the limitations on transportation deductions described in paragraphs 11.1 and 11.2, and (ii) result in a greater effective transportation

deduction or differential than those approved under paragraphs 11.1 and 11.2. Nothing herein shall prohibit Amoco, Hess and Shell from entering into non-Affiliate transactions which are not designed to avoid or circumvent the limitations on transportation deductions in paragraphs 11.1 and 11.2 regardless of whether such transactions result in transportation deductions for royalty settlement purposes to their Respective Owners greater than those approved in paragraphs 11.1 and 11.2. This provision is intended only to prohibit the use by Amoco, Hess or Shell of a transportation deduction or differential resulting from the type of transaction described in this paragraph 11.3 in deriving their respective royalty settlement values and paying royalty to their Respective Owners. Any claim that Amoco, Hess or, Shell have entered into such a transaction and have used such deduction or differential in deriving their respective royalty settlement values shall be considered to be one for breach of the Settlement Agreement and not subject to mandatory arbitration under paragraph 16 below. It shall be a complete defense to any such claim that the transportation deduction or differential utilized does not exceed the transportation deductions described in paragraphs 11.1 and 11.2 above.

11.4 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, with respect to volumes of Unit CO2 taken by a Defendant or Defendants attributable to their respective working interests in the Unit, whether equal to, less than or more than their respective entitlements, and transported to the Postle Connection Point, such Defendant or Defendants shall not, directly or indirectly, utilize any transportation allowance or charge for such transportation in calculating their respective

royalty payments to their Respective Owners. This means, as example only, that the Defendants shall not, for purposes of calculating their respective royalty payments to their Respective Owners, deduct any charge for transportation up to the Postle Connection Point, and the price or value of any Unit CO2 sold or exchanged by Defendants shall include, for purposes of calculating their respective royalty payments to their Respective Owners, any amount charged for transportation of such Unit CO2 from the Unit Tailgate up to the Postle Connection Point, irrespective of the point of sale or exchange between the selling or delivering Defendant or Defendants and the buyer or other party. Nothing herein shall constitute any acknowledgment that Exxon, Hess or Shell has made any charge of the type described above.

11.5 Nothing in this Agreement shall be construed to obligate Amoco, Hess or Shell to pay royalties to their Respective Owners on volumes of Unit CO2 other than those described in paragraph 14(a) below.

12. Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, the sales price under the 1994 Contract shall not be used by Defendants as a basis or benchmark for calculating their respective royalty payments to their Respective Owners. The price used by Amoco in calculating royalties for volumes delivered under such contract shall be based on the volume weighted average price obtained by Amoco for Unit CO2 under its other sales or dispositions. Nothing herein shall constitute any acknowledgment that Exxon and Shell used the 1994 Contract as a basis or benchmark for calculating royalty payments.

13. Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, each Defendant shall not, for purposes of calculating its respective royalty settlement values to be utilized in accounting to its Respective Owners, use a Unit weighted average price that includes the royalty settlement values for the volumes of Unit CO2 disposed of by other Defendants or other working interest owners in the Unit obtained in their sales or other dispositions from the Unit; provided, however:

(a) The foregoing prohibition is not intended to alter or affect the provisions of the Unit Agreement or other applicable contracts, if any, to which members of the Class are parties, concerning the allocation of Unit CO2 to the Defendants' Respective Owners.

(b) The Parties acknowledge that Defendants shall be entitled to continue, alter, effect or enter into agreements or procedures among working interest owners in the Unit, which concern or adjust for the impact, exclusively as among the working interest owners, of disproportionate takes of Unit CO2 or of dispositions at different prices, provided that such agreements or procedures do not modify or impair the obligations of the Defendants owed to the Class under this Agreement. By way of example only, nothing in this Agreement shall preclude Defendants from cross-invoicing among the working interest owners in the Unit to adjust for disproportionate takes or dispositions by different working interest owners at different prices, or from providing working interest owners in the Unit with (or receiving from other working interest owners) volume, price and cost data for working interest owners in the Unit on a monthly basis or otherwise so that they may accomplish such cross-invoicing, or from providing or receiving such information so that they may pay

royalties to individuals and entities that are not Plaintiffs or members of the Class. Plaintiffs and the members of the Class will reasonably cooperate in implementation of the elimination of weighted average pricing as to Plaintiffs and members of the Class provided for in this paragraph 13, provided their rights hereunder are not impaired.

(c) Nothing herein shall prohibit each Defendant, in calculating royalties payable to its Owners, from using a volume weighted average of its own sales or other dispositions of Unit CO2, except as provided in paragraph 12.

14. Amoco, Hess and Shell, effective for Unit CO2 production occurring on and after January 1, 1998, will utilize the royalty settlement methodology and the identified benchmarks set forth in subparagraphs (a), (b) and (c) below for the purpose of calculating and paying royalty to their Respective Owners, which methodology, benchmarks and resulting payments are hereby agreed to and approved by Amoco's, Hess' and Shell's Respective Owners:

(a) Amoco, Hess and Shell will each pay royalty to their Respective Owners for volumes of Unit CO2 allocated pursuant to the Unit Agreement and any other applicable contracts (to the extent there are any to which any of the Owners are parties).

(b) Amoco, Hess and Shell will each pay royalty to their Respective Owners for the volumes referenced in subparagraph 14(a) on the basis of the volume weighted average of the prices for their respective sales or other dispositions of Unit CO2 that they separately dispose of or take in kind. The volume weighted average price shall be determined by Amoco, Hess and Shell, respectively, subject to the provisions of paragraphs 9.2 and 9.3, and 10 through 13 above,

and to all provisions of the Unit Agreement that are not altered or affected by the provisions hereof, including, without limitation, the minimum royalty provisions and any other unaffected provisions of Article 6 of the Unit Agreement.

(c) Subject to the provisions of subparagraph 14(j) below, Amoco, Hess and Shell will pay their Respective Owners for volumes, as provided in subparagraph 14(a), on the basis of the volume weighted average of their respective prices for Unit CO2, as provided in subparagraph 14(b), utilizing a net-back methodology to adjust their respective prices for sales or other dispositions occurring downstream of the Unit Tailgate, and utilizing the prices or values established in their respective Qualified Contracts (as defined in subparagraph 14(e)) that apply to the volumes of Unit CO2 sold or delivered under such Contracts, their respective transportation charges established as Qualified Other Transportation Charges (as defined in subparagraph 14(f)) to the extent they apply and govern the volumes transported, and their respective Approved Mainline Deductions or, as applicable, reduced Approved Mainline Deductions (as defined in paragraphs 11.1 and 11.2), to the extent they apply and govern the volumes transported. The foregoing shall apply, as to Amoco and Amoco Owners, to the, determination of the sales price under the Amoco Production-Amoco Oil Contract and similar arrangements, and the "price or value established" under such Contract, as used above, shall refer to the CO2 sales price as determined from the injection projects' CO2 contracts before adjustment or deduction. Subject to paragraph 11.4, the November 1, 1995 exchange contract between Amoco Oil Company and Mobil Exploration and Production is approved as a Qualified Contract as long as the price determined thereunder is established in accordance

with Amoco's current practice. Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or approved herein, or that future royalty payments resulting from the use of such benchmarks, are improper. Amoco, Hess and Shell, on the one hand, and Plaintiffs and members of the Class, on the other, intend, only, to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper.

(d) The Approved Mainline Deductions shall be those allowed in paragraph 11.1 above, as to Amoco, and in paragraph 11.2 above, as to Hess and Shell.

(e) Qualified Contracts, as to Amoco, Hess and Shell respectively, shall be those contracts listed in Exhibit D-1 (Amoco), D-2 (Hess) and D-3 (Shell).

(f) Qualified Other Transportation Charges, as to Amoco, Hess, and Shell respectively, shall be those charges for transportation or related services provided for under the contracts or other arrangements listed in Exhibit E-1 (Amoco), E-2 (Hess) and E-3 (Shell).

(g) Non-Qualified Contracts shall mean and include all contracts for the sale, exchange, or other disposition of CO2 entered into by Amoco, Hess, or Shell after the date of this Agreement or not listed in Exhibit D-1, D-2 or D-3.

(h) Non-Qualified Other Transportation Charges shall mean and include any charges for transportation or related services (other than, those covered in paragraphs 11.1, 11.2 and 11.4 hereof) provided for under contracts or new arrangements relating to Unit CO2 entered into by Amoco, Hess, or Shell

after the date of this Agreement, or under contracts or arrangements not listed in Exhibit E-1, E-2 or E-3.

(i) The approval as provided herein of prices or values established under Qualified Contracts shall extend for the term of such contracts and to those volumes governed thereby. The approval as provided, herein of charges as Qualified Other Transportation Charges shall extend and apply for the term of the contracts establishing the charge or during the period the arrangement(s) remain in effect that establish the charge. With regard to any amendments, changes, or extensions of Qualified Contracts or of contracts or arrangements establishing Qualified Other Transportation Charges occurring after the date of this Agreement and that extend the term of the contracts, affect the volumes covered, price to be paid or price formula to be utilized, or charge to be imposed or formula to be utilized in establishing such charge, such approval shall not extend or apply to the volumes affected by such amendments, changes, or extensions. Further, with respect to Amoco, the approval of Amoco's Qualified Contracts shall not include any additional injection projects or volumes that are included in the Amoco Production-Amoco Oil Contract after the date of this Agreement.

(j) Nothing herein shall constitute approval of or allow the deduction, directly or indirectly, of any cost that is prohibited or limited in paragraphs 9.2, 9.3, and 10 through 13 above. Nothing herein shall allow the use of the 1994 Contract as a Qualified or Non-Qualified Contract. It is acknowledged and agreed that, as between the Parties hereto, transportation charges and related services as used herein are not intended to include costs of Unit Compression, Dehydration, and Gathering. With respect to Non-Qualified Contracts and Non-Qualified Other Transportation Charges, nothing herein shall be construed

to affect or supplant any legal or contractual duties that may be owed by Amoco, Hess, or Shell to their Respective Owners in entering into contracts for the sale or other disposition of Unit CO2 and accounting for royalty thereon, or in incurring or establishing transportation charges or transportation deductions utilized in accounting for royalty, or to waive, impair or otherwise affect any future claims that may accrue in favor of the Owners relating thereto, including, but not limited to, any claim that a Non-Qualified Contract or Non-Qualified Other Transportation Charges relied upon in establishing royalty settlement values is improper for any reason.

15. Plaintiffs, members of the Class, and Amoco, Hess and Shell acknowledge and agree that nothing in paragraph 14 above is intended to modify or amend existing contractual relationships between Amoco, Hess or Shell and individuals or entities who are not Plaintiffs or members of the Class.

16. Any claims asserted by Plaintiffs or members of the Class against Amoco, Hess or Shell regarding (a) the price or value under Non-Qualified Contracts (or under amendments to or extensions of contracts establishing new prices or values under Qualified Contracts as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners and, (b) regarding Non-Qualified Other Transportation Charges (or amendments to or extensions of contracts or other arrangements establishing Qualified Other Transportation Charges as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding

arbitration pursuant to the following provisions. Within ten (10) days after notice by one party to the other of its demand for arbitration, which demand shall also set forth the matter or matters to be submitted and the name of its arbitrator, the other party shall name its arbitrator, identify any additional matter(s) to be submitted, and so notify the demanding party. Within ten (10) days thereafter the two arbitrators shall select a third arbitrator. The arbitrators shall decide the matters submitted within ninety (90) days of the completion of the hearing. The decision of any two of the three arbitrators shall be binding on the parties. In all other respects, arbitration shall be conducted in accordance with and pursuant to the Commercial Rules of the American Arbitration Association and judgment upon the award may be entered in any court having jurisdiction thereof. This provision concerning arbitration applies only to the claims identified in this paragraph 16 and shall, in no event, apply to any future claims for breach of this Agreement.

* * *

IN WITNESS WHEREOF, this Agreement has been executed by the undersigned as of the date set forth below.

Dated: March 31, 1998

[Signatures]

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